

KINGSWAY FINANCIAL SERVICES INC  
Form 10-K  
March 10, 2016  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K

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ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2015

OR  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-15204

Kingsway Financial Services Inc.

(Exact name of registrant as specified in its charter)

Ontario, Canada

(State or other jurisdiction of  
incorporation or organization)

45 St. Clair Avenue West, Suite 400

Toronto, Ontario

(Address of principal executive  
offices)

Not Applicable

(I.R.S. Employer Identification  
No.)

M4V 1K9

(Zip Code)

1-416-848-1171

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, no par value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of June 30, 2015, the aggregate market value of the registrant's voting common stock held by non-affiliates of registrant was \$77,000,523 based upon the closing sale price of the common stock as reported by the New York Stock Exchange. Solely for purposes of this calculation, all executive officers and directors of the registrant are considered affiliates.

The number of shares of the Registrant's Common Stock outstanding as of March 10, 2016 was 19,709,706.

**DOCUMENTS INCORPORATED BY REFERENCE**

Part III of this Form 10-K is incorporated by reference to certain sections of the Proxy Statement for the 2015 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year ended December 31, 2015.

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Caution Regarding Forward-Looking Statements

This 2015 Annual Report on Form 10-K (the "2015 Annual Report"), including the accompanying consolidated financial statements of Kingsway Financial Services Inc. ("Kingsway") and its subsidiaries (individually and collectively referred to herein as the "Company") and the notes thereto appearing in Item 8 herein (the "Consolidated Financial Statements"), Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 7 herein (the "MD&A"), and the other Exhibits and Financial Statement Schedules filed as a part hereof or incorporated by reference herein may contain or incorporate by reference information that includes or is based on forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Forward-looking statements relate to future events or future performance and reflect Kingsway management's current beliefs, based on information currently available. The words "anticipate," "expect," "believe," "may," "should," "estimate," "project," "outlook," "forecast" and variations or similar words and expressions are used to identify such forward looking information, but these words are not the exclusive means of identifying forward-looking statements. Specifically, statements about (i) the Company's ability to preserve and use its net operating losses; (ii) the Company's expected liquidity; and (iii) the potential impact of volatile investment markets and other economic conditions on the Company's investment portfolio and underwriting results, among others, are forward-looking, and the Company may also make forward-looking statements about, among other things:

its results of operations and financial condition (including, among other things, premium volume, premium rates, net and operating income, investment income and performance, return on equity, and expected current returns and combined ratios);

changes in facts and circumstances affecting assumptions used in determining the provision for unpaid loss and loss adjustment expenses;

- the number and severity of insurance claims (including those associated with catastrophe losses) and their impact on the adequacy of the provision for unpaid loss and loss adjustment expenses;
- the impact of emerging claims issues as well as other insurance and non-insurance litigation;
- orders, interpretations or other actions by regulators that impact the reporting, adjustment and payment of claims;
- changes in industry trends and significant industry developments;
- uncertainties related to regulatory approval of insurance rates, policy forms, license applications and similar matters;
- the impact of certain guarantees made by the Company;
- the ability to complete current or future acquisitions successfully;
- the ability to successfully implement our restructuring activities; and
- strategic initiatives.

For a discussion of some of the factors that could cause actual results to differ, see Item 1A, "Risk Factors," and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Estimates and Assumptions," in this 2015 Annual Report.

Except as expressly required by applicable securities laws, the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, that might arise subsequent to the date of this 2015 Annual Report.

KINGSWAY FINANCIAL SERVICES INC.

Part I

Item 1. BUSINESS

Kingsway Financial Services Inc. was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. In this report, the terms "Kingsway," the "Company," "we," "us" or "our" mean Kingsway Financial Services Inc. and all entities included in our Consolidated Financial Statements.

The Company's registered office is located at 45 St. Clair Avenue West, Suite 400, Toronto, Ontario, Canada M4V 1K9. The common shares of Kingsway are listed on the Toronto Stock Exchange and the New York Stock Exchange under the trading symbol "KFS."

Kingsway is a Canadian holding company with operating subsidiaries located in the United States. The Company operates as a merchant bank primarily engaged, through its subsidiaries, in the property and casualty insurance business. Kingsway conducts its business through the following two reportable segments: Insurance Underwriting and Insurance Services. Insurance Underwriting and Insurance Services conduct their business and distribute their products in the United States. Certain of the business descriptions below, particularly "Investments," "Reinsurance" and "Regulatory Environment," are principally or exclusively related to Insurance Underwriting. The "Debt" description below is unrelated to either segment.

Financial information about Kingsway's reportable business segments for the years ended December 31, 2015 and 2014 is contained in the following sections of this 2015 Annual Report: (i) Note 22, "Segmented Information," to the Consolidated Financial Statements; and (ii) "Results of Continuing Operations" section of MD&A.

REPORTING CURRENCY

The Consolidated Financial Statements have been presented in U.S. dollars because the Company's principal investments and cash flows are denominated in U.S. dollars. The Company's functional currency is the U.S. dollar since the substantial majority of its operations is conducted in the United States. Assets and liabilities of subsidiaries with non-U.S. dollar functional currencies are translated to U.S. dollars at period-end exchange rates, while revenue and expenses are translated at average monthly rates and shareholders' equity is translated at the rates in effect at dates of capital transactions. Foreign currency translation adjustments are included in shareholders' equity under the caption accumulated other comprehensive income. Foreign currency gains and losses resulting from transactions which are denominated in currencies other than the entity's functional currency are reflected in foreign exchange losses, net in the consolidated statements of operations.

All of the dollar amounts in this 2015 Annual Report are expressed in U.S. dollars, except where otherwise indicated. References to "dollars" or "\$" are to U.S. dollars, and any references to "C\$" are to Canadian dollars.

GENERAL DEVELOPMENT OF BUSINESS

Discontinued Operations

On April 1, 2015, the Company closed on the sale of its subsidiary, Assigned Risk Solutions Ltd. ("ARS") for \$47.0 million in cash. During the second quarter of 2015, the Company received additional post-closing cash consideration of \$2.0 million. The terms of the sale also provide for potential future earnout payments to the Company equal to 1.25% of ARS' written premium and fee income during the earnout periods. The earnout payments are payable in three annual installments beginning in April 2016 through April 2018. The Company recorded a net gain on disposal of ARS, not including future earnout payments, of \$11.3 million during 2015. As a result of the sale, ARS, previously disclosed as part of the Insurance Services segment, has been classified as a discontinued operation. The earnings of ARS are disclosed as discontinued operations in the consolidated statements of operations for all periods presented. Further information is contained in Note 4, "Disposition, Deconsolidation and Discontinued Operations," to the Consolidated Financial Statements.

Termination of Management Services Agreement

On February 24, 2015, the Company announced that it had entered into a definitive agreement with 1347 Property Insurance Holdings, Inc. ("PIH") to terminate the Management Services Agreement ("MSA") previously entered into on February 11, 2014. Pursuant to the transaction, the Company received the following consideration: \$2.0 million in cash; \$3.0 million of 8% preferred stock of PIH, mandatorily redeemable in five years; a Performance Shares Grant Agreement with PIH, whereby the Company will be entitled to receive 100,000 shares of PIH common stock if at any time the last sales price of PIH's common stock equals or exceeds \$10.00 per share for any 20 trading days within any

30-trading day period; and warrants to purchase 1,500,000 shares of common stock of PIH with a strike price of \$15.00, expiring in seven years. The Company recorded a gain of \$6.0 million during

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2015 related to the termination of the MSA, which is included in other income in the consolidated statements of operations. Further information is contained in Note 24, "Related Party Transactions," to the Consolidated Financial Statements.

Deconsolidation

During the second quarter of 2015, the Company's controlling interest in Kingsway Linked Return of Capital Trust ("KLROC Trust") was reduced to zero upon the Company's repayment of its C\$15.8 million outstanding on its Linked Return of Capital ("LROC") preferred units due June 30, 2015. As a result, the Company recorded a non-cash loss on deconsolidation of KLROC Trust of \$4.4 million during 2015. This reported loss results from removing the net assets and accumulated other comprehensive loss of KLROC Trust from the Company's consolidated balance sheets. The deconsolidation reduced consolidated shareholders' equity by \$2.8 million at June 30, 2015. Further information is contained in Note 4, "Disposition, Deconsolidation and Discontinued Operations," to the Consolidated Financial Statements.

INSURANCE UNDERWRITING SEGMENT

The Company's property and casualty insurance business operations are conducted primarily through the following subsidiaries: Mendota Insurance Company ("Mendota"), Mendakota Insurance Company ("Mendakota"), Mendakota Casualty Company (formerly Universal Casualty Company) ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation (collectively, "Insurance Underwriting").

The insurance subsidiaries in Insurance Underwriting issue insurance policies and retain the risk of operating profit or loss related to the ultimate loss and loss adjustment expenses incurred on the underlying policies. Insurance Underwriting provides non-standard automobile insurance to individuals who do not meet the criteria for coverage by standard automobile insurers. Insurance Underwriting has policyholders in 12 states; however, new business is accepted in only nine states. In 2015, the following states accounted for 84.8% of Insurance Underwriting's gross premiums written: Florida (24.0%), Texas (16.3%), Illinois (15.7%), California (10.3%), Nevada (9.9%) and Colorado (8.6%).

The Company previously placed Amigo and MCC into voluntary run-off in 2012 and 2011, respectively. Each of Amigo and MCC entered into a comprehensive run-off plan which was approved by its respective state of domicile.

Kingsway continues to manage Amigo and MCC in a manner consistent with the run-off plans. During the first quarter of 2015, MCC sent a letter of intent to the Illinois Department of Insurance to resume writing private passenger automobile policies in the state of Illinois. MCC began writing these policies on April 1, 2015.

Effective March 31, 2014, the Company's wholly owned subsidiary, PIH, formerly known as Maison Insurance Holdings, Inc., completed an initial public offering of its common stock. Upon completion of the transaction, the Company maintained a minority ownership interest in the common shares of PIH. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. Prior to the transaction, PIH was included in the Insurance Underwriting segment. As a result of the disposal of the Company's majority interest in PIH on March 31, 2014, all segmented information has been restated to exclude PIH from the Insurance Underwriting segment.

Insurance Underwriting Products

Insurance Underwriting primarily markets automobile insurance products which provide coverage in three major areas: liability, accident benefits and physical damage. Liability insurance provides coverage for claims against the Company's insureds legally responsible for automobile accidents which have injured third-parties or caused property damage to third-parties. Accident benefit policies or personal injury protection policies provide coverage for loss of income, medical and rehabilitation expenses for insured persons who are injured in an automobile accident, regardless of fault. Physical damage policies cover damages to an insured automobile arising from a collision with another object or from other risks such as fire or theft.

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Table 1 and Table 2 summarize Insurance Underwriting's gross premiums written by line of business and by state, respectively, for the years ended December 31, 2015 and 2014.

TABLE 1 Gross premiums written by line of business

For the years ended December 31 (in thousands of dollars, except for percentages)

	2015	% of Total	2014	% of Total	
Private passenger auto liability	78,811	67.7	% 76,487	67.1	%
Auto physical damage	37,592	32.3	% 37,515	32.9	%
Total gross premiums written	116,403	100.0	% 114,002	100.0	%

TABLE 2 Gross premiums written by state

For the years ended December 31 (in thousands of dollars, except for percentages)

	2015	% of Total	2014	% of Total	
Florida	27,935	24.0	% 21,440	18.8	%
Texas	18,989	16.3	% 20,142	17.7	%
Illinois	18,265	15.7	% 17,786	15.6	%
California	12,046	10.3	% 11,363	10.0	%
Nevada	11,572	9.9	% 10,863	9.5	%
Colorado	10,027	8.6	% 11,033	9.7	%
Other	17,569	15.2	% 21,375	18.7	%
Total gross premiums written	116,403	100.0	% 114,002	100.0	%

Non-standard automobile insurance is principally provided to individuals who do not qualify for standard automobile insurance coverage because of their payment history, driving record, place of residence, age, vehicle type or other factors. Such drivers typically represent higher than normal risks and pay higher insurance rates for comparable coverage.

Non-standard automobile insurance loss experience is generally driven by higher frequency and lower severity than the standard automobile market. The higher frequency, however, is mitigated to some extent by higher premium rates; the tendency of high-risk individuals to own low-value automobiles; and generally lower limits of insurance coverage as insureds tend to purchase coverage at the minimum prescribed limits. In the United States, non-standard automobile insurance policies generally have lower limits of insurance commensurate with the minimum coverage requirements under the statute of the states in which we write the business. These limits of liability are typically not greater than \$50,000 per occurrence.

The insuring of non-standard automobile drivers is often transitory. When their driving records improve, insureds may qualify to obtain insurance in the standard market at lower premium rates. We often cancel policies for non-payment of premium and, following a period of lapse in coverage, insureds frequently return to purchase a new policy at a later date. As a result, our non-standard automobile insurance policies experience a retention rate that is lower than that experienced for standard market risks. This creates an on-going requirement to replace non-renewing policyholders with new policyholders and to react promptly to issue cancellation notices for non-payment of premiums to mitigate potential bad debt write-offs. Most of our insureds pay their premiums on a monthly installment basis, and we typically limit our risk related to non-payment of premiums by requiring a deposit for future insurance premiums and the prepayment of subsequent installments.

In the United States, automobile insurers are generally required to participate in various involuntary residual market pools and assigned risk plans that provide automobile insurance coverage to individuals or other entities that are unable to purchase such coverage in the voluntary market. Participation in these pools in most jurisdictions is in proportion to voluntary writings of selected lines of business in those jurisdictions.

Non-standard automobile insurance accounted for 100.0% of Insurance Underwriting's gross premiums written in 2015 and 2014. For the year ended December 31, 2015, gross premiums written for non-standard automobile insurance increased 2.1% to \$116.4 million as compared to \$114.0 million in 2014. The increase in gross premiums written resulted primarily from increased premium volumes written in Florida during the year ended December 31, 2015 compared to prior year.





KINGSWAY FINANCIAL SERVICES INC.

Marketing and Distribution

Our strategy focuses on developing and maintaining strong relationships with our independent agents. Insurance Underwriting's products and services are marketed through approximately 3,700 independent agencies. We maintain an "open market" approach which enables these agents to place business with us without the obligation of minimum production commitments, providing us with a broad, flexible and scalable distribution network. We continually strive to provide excellent service in the markets in which we operate, communicating through a variety of channels as we look for opportunities to increase efficiency and reduce operating costs with our agents. Our independent agents have the ability to bind insurance policies on our behalf, subject to our underwriting guidelines. Our proprietary point-of-sale systems, however, prevent any agent from binding an unacceptable risk. We do not, though, delegate authority to settle or adjust claims, establish underwriting guidelines, develop rates or enter into other transactions or commitments through our independent agents.

Texas business is originated through an affiliated managing general agent and written through an unaffiliated Texas county mutual insurance company. This business is then 100% assumed through a quota-share arrangement by one of our insurance subsidiaries. This represents a common way of originating non-standard automobile business in the state of Texas due to the greater rating and underwriting flexibility accorded Texas county mutual insurance companies under Texas statutes.

No customer or group of affiliated customers accounts for 10% or more of Insurance Underwriting's revenues, and no loss of a customer or group of affiliated customers would have a material adverse effect on the Company.

Competition

Insurance Underwriting operates in a highly competitive environment. Our core non-standard automobile offerings are policies at the minimum prescribed limits in each state produced entirely through our independent agents. We compete with large national insurance companies and smaller regional insurance companies which produce through independent agents. We also compete with insurance companies which sell policies directly to their customers.

Large national insurance companies and direct underwriters typically operate in standard lines of personal automobile and property insurance in addition to non-standard lines and generally bring with them increased name recognition obtained through extensive media advertising, loyalty of the customer base to the insurer rather than to an independent agency and, potentially, reduced policy acquisition costs and increased customer retention.

From time to time, the non-standard automobile market attracts competition from new entrants. In many cases, these entrants are looking for growth and, as a result, price their insurance below the rates that we believe provide an acceptable return for the related risk. We firmly believe that it is not in our best interest to compete solely on price; consequently, we are willing to experience a loss of market share during periods of intense price competition or soft market conditions. During the last few years, the Company carried out a detailed review of its premium adequacy in the territories in which it operates and implemented steps to terminate business where premium adequacy was unlikely to be achieved within an acceptable period of time.

In order to stay competitive while striving to generate an economic rate of return, we compete on a number of factors such as distribution strength and breadth, premium adequacy, agency relationships, ease of doing business and market reputation. Ultimately, we believe that our ability to compete successfully in our industry is based, among other things, on our ability to:

- identify markets that are most likely to produce an underwriting profit;
- operate with a disciplined underwriting approach;
- practice prudent claims management;
- establish an appropriate provision for unpaid loss and loss adjustment expenses;
- strive for cost containment and the economics of shared support functions where deemed appropriate; and
- provide our independent agents and brokers with competitive commissions, an ease of doing business and additional value-added products and services for them and their customers.

Insurance Underwriting generally does not compete on the basis of ratings assigned by insurance rating agencies. Previously, the Company's insurance subsidiaries were assigned ratings by A.M. Best. In October, 2011 the Company had the A.M. Best ratings for all of its insurance subsidiaries withdrawn. As a result, the Company's insurance subsidiaries are currently unrated.



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Underwriting

Our underwriting philosophy stresses receiving an adequate premium and spread of risks for the business we accept. We regularly monitor premium adequacy by territory, line of business and agency and take actions as necessary. Actions include, but are not limited to, tightening underwriting requirements, filing for rate increases, terminating underperforming programs and agents, non-renewing policies (where permitted) and other administrative changes. Typically, we do not reduce our premiums when competitors underwrite at premium rates that we believe are below acceptable levels. Instead, we focus on maintaining our premium per risk rather than writing a large number of risks at premiums that we believe would be inadequate and thus unprofitable. As a result, our premium volumes may be negatively impacted during a soft market.

Claims Management

Claims management is the process by which Insurance Underwriting determines the validity and amount of a claim. We believe that claims management is fundamental to our operating results. With respect to Insurance Underwriting, proper and efficient claims management has a direct effect on the operating profit or loss which has been retained related to the ultimate loss and loss adjustment expenses incurred on the underlying policies.

The individual operating subsidiaries in Insurance Underwriting primarily employ their own claims adjusters who are responsible for investigating and settling claims. Under certain circumstances, however, our operating subsidiaries will utilize each other's claims expertise where appropriate. Our goal is to settle claims fairly for the benefit of our insureds in a manner that is consistent with the insurance policy language and our regulatory and legal obligations. In addition to claims adjusters, our operating subsidiaries also employ appraisers, special investigators and salvage, subrogation and other personnel who are responsible for helping us reduce the net cost of claim-handling, particularly with respect to identifying instances of fraud. We aggressively combat fraud and have processes in place to investigate suspicious claim activity. We may also engage independent appraisers, private investigators, various experts and legal counsel to assist us in adjusting claims. When necessary, we defend litigation against our insureds generally by retaining outside legal counsel.

INSURANCE SERVICES SEGMENT

Insurance Services includes the following subsidiaries of the Company: IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity"), (collectively, "Insurance Services").

IWS is a licensed motor vehicle service agreement company and is a provider of after-market vehicle protection services distributed by credit unions in 26 states to their members.

Trinity is a provider of warranty products and maintenance support to consumers and businesses in the heating, ventilation, air conditioning ("HVAC"), standby generator, commercial LED lighting and refrigeration industries.

Trinity distributes its warranty products through original equipment manufacturers, HVAC distributors and commercial and residential contractors. Trinity distributes its maintenance support direct through corporate owners of retail spaces throughout the United States.

As described above, effective April 1, 2015, the Company closed on the sale of its wholly owned subsidiary, ARS. As a result, ARS has been classified as discontinued operations and the results of their operations are reported separately for all periods presented. Prior to the transaction, ARS was included in the Insurance Services segment. As a result of classifying ARS as a discontinued operation, all segmented information has been restated to exclude ARS from the Insurance Services segment.

Insurance Services Products

IWS markets and administers vehicle service agreements and related products for new and used automobiles throughout the United States. A vehicle service agreement is an agreement between IWS and the vehicle purchaser under which IWS agrees to replace or repair, for a specific term, designated vehicle parts in the event of a mechanical breakdown. IWS serves as the administrator on all contracts it originates. Vehicle service agreements supplement, or are in lieu of, manufacturers' warranties and provide a variety of extended coverage options. Vehicle service agreements typically range from three months to seven years and/or 3,000 miles to 100,000 miles. The cost of the vehicle service agreement is a function of the contract term, coverage limits and type of vehicle.

In addition to marketing vehicle service agreements, IWS also brokers a guaranteed asset protection product ("GAP") through its distribution channel. GAP generally covers a consumer's out-of-pocket amount, related to an automobile

loan or lease, if the vehicle is stolen or damaged beyond repair. IWS earns a commission when a consumer purchases a GAP certificate but does not take on any insurance risk.

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Trinity is a provider of HVAC, standby generator, commercial LED lighting and refrigeration warranty products and provider of equipment breakdown and maintenance support services to companies across the United States. As a provider of warranty products, Trinity markets and administers product warranty contracts for certain new and used products in the HVAC, standby generator, commercial LED lighting and refrigeration industries throughout the United States. A warranty contract is an agreement between Trinity and the purchaser of such HVAC, standby generator, commercial LED lighting and refrigeration equipment to replace or repair, for a specific term, designated parts in the event of a mechanical breakdown. As a provider of equipment breakdown and maintenance support services, Trinity acts as a single point of contact to its clients for both certain equipment breakdowns and scheduled maintenance of equipment. Trinity will provide such repair and breakdown services by contracting with certain HVAC providers.

### Marketing and Distribution

IWS markets its products primarily through credit unions. IWS enters into an exclusive agreement with each credit union whereby the credit union receives a stipulated access fee for each vehicle service agreement issued to its members. The credit unions are served by IWS employee representatives located throughout the United States in close geographical proximity to the credit unions they serve. IWS distributes and markets its products in 26 states.

Trinity directly markets and distributes its warranty products to manufacturers, distributors and installers of HVAC, standby generator, commercial LED lighting and refrigeration equipment. As a provider of equipment breakdown and maintenance support, Trinity directly markets and distributes its product through its clients, which are primarily companies that directly own and operate numerous locations across the United States.

No customer or group of affiliated customers accounts for 10% or more of Insurance Service's revenues, and no loss of a customer or group of affiliated customers would have a material adverse effect on the Company.

### Competition

IWS focuses exclusively on the automotive finance market with its core vehicle service agreement and related product offerings, while much of its competition in the credit union channel has a less targeted product approach. IWS' typical competitor takes a generalist approach to market by providing credit unions with a variety of different product offerings. They are thus unable to deliver specialty expertise on par with IWS and do not give vehicle service agreement products the attention they require for healthy profitability and strong risk management.

Trinity operates in an environment with few market competitors. Trinity competes on two important facets: its belief that it provides superior customer service relative to its competitors and its ability, through the support of its insurance company partners, to provide warranty solutions to a wider range of HVAC, standby generator, commercial LED lighting and refrigeration equipment than that of its competitors.

### Claims Management

Claims management is the process by which Insurance Services determines the validity and amount of a claim. We believe that claims management is fundamental to our operating results. The individual operating subsidiaries in Insurance Services primarily employ their own claims adjusters who are responsible for investigating and settling claims. Our goal is to settle claims fairly for the benefit of our insureds and the insureds of our insurance company partners in a manner that is consistent with the insurance policy language and our regulatory and legal obligations. IWS effectively and efficiently manages claims by utilizing in-house expertise and information systems. IWS employs an experienced claims staff comprised of Automotive Service Excellence certified mechanics, knowledgeable in all aspects of vehicle repairs and potential claims. Additionally, IWS owns its own proprietary database of historical claims data dating back over twenty years. Management analyzes this database to drive real-time pricing adjustments and strategic decision-making.

Trinity claims on warranty products are managed by the insurance companies with which Trinity partners. Trinity may, at times, act as a third-party administrator of such claims; however at no time does Trinity bear the loss of claims on warranty products.

### PRICING AND PRODUCT MANAGEMENT

Responsibility for pricing and product management rests with the Company's individual operating subsidiaries in each of Insurance Underwriting and Insurance Services. Typically, teams comprised of pricing actuaries, product managers and business development managers work together by territory to develop policy forms and language, rating

structures, regulatory filings and new product ideas. Data solutions and claims groups track loss performance on a monthly basis so as to alert the operating subsidiaries to the potential need to adjust forms or rates.

KINGSWAY FINANCIAL SERVICES INC.

UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

Kingsway records a provision for its unpaid losses that have occurred as of a given evaluation date as well as for its estimated liability for loss adjustment expenses. The provision for unpaid losses includes a provision, commonly referred to as case reserves, for losses related to reported claims as well as a provision for losses related to claims incurred but not reported ("IBNR"). The provision for loss adjustment expenses represents the cost to investigate and settle claims.

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

Any adjustments to the provision for unpaid loss and loss adjustment expenses are reflected in the consolidated statements of operations in the periods in which they become known, and the adjustments are accounted for as changes in estimates. Even after such adjustments, ultimate liability or recovery may exceed or be less than the revised provisions. An adjustment that increases the provision for unpaid loss and loss adjustment expenses is known as an unfavorable development or a deficiency and will reduce net income while an adjustment that decreases the provision is known as a favorable development or a redundancy and will increase net income.

Process for Establishing the Provision for Unpaid Loss and Loss Adjustment Expenses

The process for establishing the provision for unpaid loss and loss adjustment expenses reflects the uncertainties and significant judgmental factors inherent in predicting future results of both reported and IBNR claims. As such, the process is inherently complex and imprecise and estimates are constantly refined. The process of establishing the provision for unpaid loss and loss adjustment expenses relies on the judgment and opinions of a large number of individuals, including the opinions of the Company's actuaries.

Factors affecting the provision for unpaid loss and loss adjustment expenses include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claims departments' personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future loss settlement costs, court decisions, economic conditions and public attitudes.

The process for establishing the provision for loss and loss adjustment expenses begins with the collection and analysis of claim data. Data on individual reported claims, both current and historical, including paid amounts and individual claim adjuster estimates, are grouped by common characteristics and evaluated by actuaries in their analyses of ultimate claim liabilities by product line. Such data is occasionally supplemented with external data as available and when appropriate. The process of analyzing the provision is undertaken on a regular basis, generally quarterly, in light of continually updated information.

Multiple estimation methods are available for the analysis of the provision for loss and loss adjustment expenses. Each estimation method has its own set of assumption variables and its own advantages and disadvantages, with no single estimation method being better than the others in all situations and no one set of assumption variables being meaningful for all product line components. The relative strengths and weaknesses of the particular estimation methods when applied to a particular group of claims can also change over time; therefore, the actual choice of estimation method can change with each evaluation. The estimation methods chosen are those that are believed to produce the most reliable indication at that particular evaluation date.

In most cases, multiple estimation methods will be valid for the evaluation of the provision for loss and loss adjustment expenses. This will result in a range of reasonable estimates for the provision. Reported values found to be closer to the endpoints of a range of reasonable estimates are subject to further detailed reviews. These reviews may substantiate the validity of management's recorded provision or lead to a change in the reported provision.

The exact boundary points of these ranges are more qualitative than quantitative in nature, as no clear line of demarcation exists to determine when the set of underlying assumptions for an estimation method switches from being



reasonable to unreasonable. As a result, the Company does not believe that the endpoints of these ranges are or would be comparable across companies. In addition, potential interactions among the different estimation assumptions for different product lines make the aggregation of individual ranges a highly judgmental and inexact process.

A basic premise in most actuarial analyses is that past patterns demonstrated in the data will repeat themselves in the future, absent a material change in the associated risk factors discussed below. To the extent a material change affecting the ultimate provision for loss and loss adjustment expenses is known, such change is quantified to the extent possible through an analysis of internal

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company data and, if available and when appropriate, external data. Such a measurement is specific to the facts and circumstances of the particular claim portfolio and the known change being evaluated. Significant structural changes to the available data, product mix or organization can materially impact the provision for loss and loss adjustment expenses.

Informed judgment is applied throughout the process. This includes the application of various individual experiences and expertise to multiple sets of data and analyses. In addition to actuaries, experts involved with the reserving process also include underwriting and claims personnel and lawyers, as well as other company management. As a result, management may have to consider varying individual viewpoints when establishing the provision for loss and loss adjustment expenses.

#### Variables Influencing the Provision for Unpaid Loss and Loss Adjustment Expenses

The variables discussed above have different impacts on estimation uncertainty for a given product line, depending on the length of the claim tail, the reporting lag, the impact of individual claims and the complexity of the claim process for a given product line.

Property and casualty insurance policies are either written on a claims-made or occurrence basis. Claims-made policies generally cover, subject to requirements in individual policies, claims reported during the policy period. Policies that are written on an occurrence basis require that the insured demonstrate that a loss occurred in the policy period, even if the insured reports the loss in a later policy period.

Product lines are generally classifiable as either long-tail or short-tail, based on the average length of time between the event triggering claims under a policy and the final resolution of those claims. Short-tail claims are reported and settled quickly, resulting in less estimation variability. The longer the time before final claim resolution, the greater the exposure to estimation risks and hence the greater the estimation uncertainty.

A major component of the claim tail is the reporting lag. The reporting lag, which is the time between the event triggering a claim and the reporting of the claim to the insurer, makes estimating IBNR inherently more uncertain. In addition, the greater the reporting lag, the greater the proportion of IBNR to the total provision for the product line. Writing new products with material reporting lags can result in adding several years' worth of IBNR claim exposure before the reporting lag exposure becomes clearly observable, thereby increasing the risk associated with pricing and reserving such products.

For some lines, the impact of large individual claims or loss events, such as catastrophes, can be material to the analysis. These lines are generally referred to as being "low frequency/high severity," while lines without this "large claim" sensitivity are referred to as "high frequency/low severity." The provision for low frequency/high severity lines can be sensitive to the impact of a small number of potentially large claims or a small number of significant loss events, such as catastrophes. As a result, the role of judgment is much greater for these provisions. In contrast, for high frequency/low severity lines, the impact of individual claims is relatively minor and the range of reasonable provision estimates is narrower and more stable.

Claim complexity can also greatly affect the estimation process by impacting the number of assumptions needed to produce the estimate, the potential stability of the underlying data and claim process, and the ability to gain an understanding of the data. Product lines with greater claim complexity have inherently greater estimation uncertainty. Actuaries have to exercise a considerable degree of judgment in the evaluation of all these factors in their analysis of the provision for loss and loss adjustment expenses. The human element in the application of actuarial judgment is unavoidable when faced with material uncertainty. Different actuaries may choose different assumptions when faced with such uncertainty, based on their individual backgrounds, professional experiences and areas of focus. Hence, the estimates selected by the various actuaries may differ materially from each other.

Lastly, significant structural changes to the available data, product mix or organization can also materially impact the process for establishing the provision for loss and loss adjustment expenses.

#### Property and Casualty Insurance

The Company's insurance policies are generally written on an occurrence basis. Non-standard automobile includes both short and long-tail coverages. The payments that are made quickly typically pertain to auto physical damage and property damage claims. The payments that take longer to finalize and are more difficult to estimate relate to bodily injury claims. Reporting lags are relatively short, and the claim settlement process for personal automobile liability

generally is the least complex of the liability products. Given that our core non-standard automobile offerings are policies at the minimum prescribed limits in each state, our non-standard automobile business is generally viewed as a high frequency, low severity business.

Examples of common risk factors that could change and, thus, affect the provision for loss and loss adjustment expenses for the non-standard automobile product line include, but are not limited to:

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- trends in jury awards;
- changes in the underlying court system and its philosophy;
- changes in case law;
- litigation trends;
- frequency of claims with payment capped by policy limits;
- change in average severity of accidents, or proportion of severe accidents;
- subrogation opportunities;
- degree of patient responsiveness to treatment;
- changes in claim handling philosophies;
- effectiveness of no-fault laws;
- frequency of visits to health providers;
- number of medical procedures given during visits to health providers;
- types of health providers used;
- types of medical treatments received;
- changes in cost of medical treatments;
- changes in policy provisions (e.g., deductibles, policy limits, endorsements, etc.);
- changes in underwriting standards; and
- changes in the use of credit data for rating and underwriting.

Historical Development of Property and Casualty Unpaid Loss and Loss Adjustment Expenses

Table 3 summarizes the changes over time in the Company's provision for property and casualty unpaid loss and loss adjustment expenses.

The first section of the table shows the provision for property and casualty unpaid loss and loss adjustment expenses recorded at the balance sheet date for each of the indicated years. The original provision for each year is presented on a gross basis as well as net of estimated reinsurance recoverable on unpaid loss and loss adjustment expenses.

The second section displays the cumulative amount of payments made through the end of each subsequent year with respect to each original provision. The third section presents the re-estimation over subsequent years of each year's original net liability for property and casualty unpaid loss and loss adjustment expenses as more information becomes known and trends become more apparent. The final section compares the latest re-estimation to the original estimate for each year presented in the table on both a gross and net basis.

The development of the provision for property and casualty unpaid loss and loss adjustment expenses is shown by the difference between the original estimates and the re-estimated liabilities at each subsequent year-end. The re-estimated liabilities at each year-end are based on actual payments in full or partial settlement of claims plus re-estimates of the payments required for claims still open or IBNR claims. Favorable development (redundancy) means that the original estimated provision was higher than subsequently re-estimated. Unfavorable development (deficiency) means that the original estimated provision was lower than subsequently re-estimated. The cumulative development represents the aggregate change in the estimates over all prior years.

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TABLE 3 Provision for property and casualty unpaid loss and loss adjustment expense, net of recoveries from reinsurers

As of December 31, 2015 (in thousands of dollars, except percentages)

	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005
Property and casualty unpaid loss and loss adjustment expenses originally established - end of year, gross	55,471	63,895	84,534	103,116	120,258	174,708	186,685	183,151	197,951	119,150	106,820
Less: reinsurance recoverable on property and casualty unpaid loss and loss adjustment expenses	1,207	3,203	7,942	5,478	298	7,974	—	499	327	301	481
Property and casualty unpaid loss and loss adjustment expenses originally established - end of year, net	54,264	60,692	76,592	97,638	119,960	166,734	186,685	182,652	197,624	118,849	106,340
Cumulative net paid as of:											
One year later		39,068	42,428	53,426	70,046	105,201	111,676	107,139	108,615	48,817	50,040
Two years later			56,746	72,091	99,444	141,165	155,494	156,753	150,535	75,525	71,018
Three years later				81,279	108,966	162,233	175,318	180,437	174,313	90,925	83,889
Four years later					115,386	170,194	188,024	190,763	183,621	98,801	91,333
Five years later						174,897	192,260	196,034	186,908	101,392	94,894
Six years later							195,048	197,798	188,791	102,749	96,144
Seven years later								198,905	189,399	103,020	97,365
Eight years later									190,133	103,295	97,560

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Nine years later									103,571	97,684
Ten years later										97,950
Re-estimated liability as of:										
One year later	61,308	71,471	96,459	133,790	174,640	201,086	184,462	190,176	108,978	105,099
Two years later		69,787	90,193	133,793	185,019	201,978	197,621	186,915	104,908	98,230
Three years later			89,578	127,131	187,144	206,787	197,961	193,305	106,018	96,552
Four years later				125,930	182,517	209,636	200,983	191,902	106,835	97,618
Five years later					181,774	206,123	201,276	191,969	105,977	98,024
Six years later						205,593	197,705	192,913	105,992	98,340
Seven years later							197,169	188,604	105,942	99,079
Eight years later								188,487	104,164	99,340
Nine years later									103,894	98,764
Ten years later										98,576
As of December 31, 2015:										
Cumulative deficiency (redundancy)	616	(6,805 )	(8,060 )	5,970	15,040	18,908	14,517	(9,137 )	(14,955 )	(7,768 )
Cumulative deficiency (redundancy) as a % of property and casualty unpaid loss and loss adjustment expenses originally established - net	1.0	% (8.9 )	)% (8.3 )	)% 5.0	% 9.0	% 10.1	% 7.9	% (4.6 )	)% (12.6 )	)% (7.3 )
Re-estimated liability - gross	61,308	69,787	89,578	125,930	189,221	205,593	197,169	188,487	103,894	98,576
Less: re-established reinsurance recoverable	—	—	—	—	7,447	—	—	—	—	—

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Re-estimated provision - net	61,308	69,787	89,578	125,930	181,774	205,593	197,169	188,487	103,894	98,576
Cumulative deficiency (redundancy) - gross	(2,587 )	(14,747 )	(13,538 )	5,672	14,513	18,908	14,018	(9,464 )	(15,256 )	(8,249 )
% of property and casualty unpaid loss and loss adjustment expenses originally established - gross	(4.0 )%	(17.4 )%	(13.1 )%	4.7 %	8.3 %	10.1 %	7.7 %	(4.8 )%	(12.8 )%	(7.7 )%

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## Rollforward of Property and Casualty Unpaid Loss and Loss Adjustment Expenses

Table 4 shows a rollforward of the provision for property and casualty unpaid loss and loss adjustment expenses, net of amounts recoverable from reinsurers. The effect on the Company's net loss during the past two years due to changes in estimates of prior year property and casualty unpaid loss and loss adjustment expenses is shown as the "prior years" contribution to incurred losses. The consolidated financial statements are presented on a calendar year basis for all data. Calendar year results reflect payments and re-estimation of the provision that have been recorded in the consolidated financial statements during the applicable reporting period without regard to the periods in which the original losses were incurred. Calendar year results do not change after the end of the applicable reporting period, even as new information develops.

TABLE 4 Rollforward of property and casualty unpaid loss and loss adjustment expenses

As of December 31 (in thousands of dollars)

	2015	2014
Balance at beginning of period, gross	63,895	84,534
Less reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	3,203	7,942
Balance at beginning of period, net	60,692	76,592
Incurred related to:		
Current year	86,439	84,577
Prior years	616	(5,123)
Paid related to:		
Current year	(54,415)	(52,521)
Prior years	(39,068)	(42,428)
Disposal of unpaid loss and loss adjustment expenses related to PIH	—	(405)
Balance at end of period, net	54,264	60,692
Plus reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	1,207	3,203
Balance at end of period, gross	55,471	63,895

## INVESTMENTS

We manage our investments to support the liabilities of our insurance operations, preserve capital, maintain adequate liquidity and maximize after-tax investment returns within acceptable risks. The fixed maturities portfolios are managed by a third-party firm and are comprised predominantly of high-quality fixed maturities with relatively short durations. Equity, limited liability and other investments are managed by a team of employees and advisors dedicated to the identification of investment opportunities that offer asymmetric risk/reward potential with a margin of safety supported by private market values. The Investment and Capital Committee of the Board of Directors is responsible for monitoring the performance of our investments and compliance with the Company's investment policies and guidelines, which it reviews annually. We are also subject to the applicable state regulations that prescribe the type, quality and concentration of investments that individual insurance companies can make.

For further descriptions of the Company's investments, see our disclosures under the headings "Net Investment Income," "Net Realized Gains," "Investments," "Liquidity and Capital Resources" and "Critical Accounting Estimates and Assumptions" in the MD&A and Note 5, "Investments," and Note 23, "Fair Value of Financial Instruments," to the Consolidated Financial Statements.

## REINSURANCE

For most of the non-standard automobile business that we write, our exposure is generally limited to the minimum statutory liability limits, which are typically not greater than \$50,000 per occurrence, depending on the state. We have from time to time, though, entered into different types of reinsurance arrangements as part of the management of our non-standard automobile business. For 2015 and 2014, we entered into an excess of loss reinsurance arrangement to reduce our exposure to losses related to certain catastrophic events which may occur in any of the states in which we write non-standard automobile business.



Reinsurance ceded does not relieve us of our ultimate liability to our insureds in the event that any reinsurer is unable to meet its obligations under its reinsurance contracts. We therefore enter into reinsurance contracts with only those reinsurers which we believe have sufficient financial resources to meet their obligations to us. Reinsurance treaties generally have terms of one year and, as a result, are subject to renegotiation annually.

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Because our reinsurance recoverable is generally unsecured, we regularly evaluate the financial condition of our reinsurers and monitor the concentrations of credit risk to minimize our exposure to significant losses as a result of the insolvency of a reinsurer. We believe that the amounts we have recorded as reinsurance recoverable are appropriately established. Estimating our reinsurance recoverable, however, is subject to various uncertainties and the amounts ultimately recoverable may vary from amounts currently recorded. Estimating amounts of reinsurance recoverable is also impacted by the uncertainties involved in the establishment of provisions for unpaid loss and loss adjustment expenses. As our underlying provision develops, the amounts ultimately recoverable may vary from amounts currently recorded.

As of December 31, 2015, we had \$1.4 million recoverable from third-party reinsurers. As shown in Table 5 below, at December 31, 2015, 100.0% of the amounts recoverable from third-party reinsurers were due from reinsurers that were rated "A-" or higher by the A.M. Best rating service. We regularly evaluate our reinsurers and their respective amounts recoverable, and an allowance for uncollectible reinsurance is provided, if needed.

TABLE 5 Composition of amounts due from reinsurers by A.M. Best rating

As of December 31, 2015

A+	65.0	%
A-	35.0	%
Total	100.0	%

## DEBT

Debt includes LROC preferred units and subordinated debt, both of which are carried at fair value.

Debt consists of the following instruments:

TABLE 6 Debt

As of December 31 (in thousands of dollars)

	2015		2014	
	Principal	Fair Value	Principal	Fair Value
LROC preferred units due 2015	—	—	13,618	13,618
Subordinated debt	90,500	39,898	90,500	40,659
Total	90,500	39,898	104,118	54,277

Further information regarding our debt is discussed within the "Debt" section of MD&A as well as in Note 13, "Debt," to the Consolidated Financial Statements.

## REGULATORY ENVIRONMENT

Our insurance subsidiaries are subject to extensive regulation in the states in which they do business. Such regulation pertains to a variety of matters, including, but not limited to, policy forms, premium rate plans, licensing of agents, licenses to transact business, trade practices, claims practices, investments, payment of dividends, transactions with affiliates and solvency. The majority of our insurance is written in states requiring prior approval by regulators before proposed rates for property and casualty policies may be implemented.

Our U.S. insurance subsidiaries are subject to the insurance holding company laws in the jurisdictions in which they conduct business. These regulations require that each U.S. insurance company in the holding company system register with the insurance department of its state of domicile and furnish information concerning the operations of companies in the holding company system which may materially affect the operations, management or financial condition of the insurers in the holding company domiciled in that state. We have U.S. insurance subsidiaries that are organized and domiciled under the insurance statutes of Illinois, Minnesota and Florida. The insurance laws in each of these states similarly provide that all transactions among members of a holding company system be done at arm's length and be shown to be fair and reasonable to the regulated insurer. Transactions between insurance company subsidiaries and their parents and affiliates typically must be disclosed to the state regulators, and any material or extraordinary transaction requires prior approval of the applicable state insurance regulator. A change of control of a domestic insurer or of any controlling person requires the prior approval of the state insurance regulator. In general, any person who acquires 10% or more of the outstanding voting securities of the insurer or its parent company is presumed to have acquired control of the domestic insurer. To the best of our knowledge, we are in compliance with the regulations discussed above.



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We are a holding company with no business operations of our own. Our ability to meet our debt payment obligations and cover our operating expenses is largely dependent on dividends or other payments from our non-insurance subsidiaries as well as the sale of assets held by the holding company and the issuance of securities to raise capital. Dividends declared and paid by an insurance subsidiary are subject to certain restrictions which may require prior approval by the insurance regulators of the state in which such subsidiary is domiciled. At this time, the U.S. insurance subsidiaries of the Company are restricted from making any dividend payments to the holding company without regulatory approval pursuant to the domiciliary state insurance regulations. Other transactions between our insurance company subsidiaries and their affiliates generally must be disclosed to state regulators, and prior regulatory approval generally is required before any material or extraordinary transaction may be consummated or any management agreement, services agreement, expense sharing arrangement or other contract providing for the rendering of services on a regular, systematic basis is executed.

Insurance companies are required to report their financial condition and results of operation in accordance with statutory accounting principles prescribed or permitted by state insurance regulators in conjunction with the National Association of Insurance Commissioners ("NAIC"). State insurance regulators also prescribe the form and content of statutory financial statements, perform periodic financial examinations of insurers, set minimum reserve and loss ratio requirements, establish standards for the types and amounts of investments and require minimum capital and surplus levels. Such statutory capital and surplus requirements reflect risk-based capital ("RBC") standards promulgated by the NAIC. These RBC standards are intended to assess the level of risk inherent in an insurance company's business and consider items such as asset risk, credit risk, underwriting risk and other business risks relevant to its operations. In accordance with RBC formulas, an insurance company's RBC requirements are calculated and compared to its total adjusted capital, as defined by the NAIC, to determine whether regulatory intervention is warranted. In general, insurers reporting surplus as regards policyholders below 200% of the authorized control level, as defined by the NAIC, at December 31 are subject to varying levels of regulatory action, including discontinuation of operations. As of December 31, 2015, surplus as regards policyholders reported by each of our insurance subsidiaries exceeded the 200% threshold.

Our insurance subsidiaries are required under the guaranty fund laws of most states in which they transact business to pay assessments up to prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. Our insurance subsidiaries also are required to participate in various involuntary pools or assigned risk pools. In most states, the involuntary pool participation of our insurance subsidiaries is in proportion to their voluntary writings of related lines of business in such states.

We operate under licenses issued by various state insurance authorities. These licenses govern, among other things, the types of insurance coverage and agency and claim services that we may offer consumers in these states. Such licenses typically are issued only after we file an appropriate application and satisfy prescribed criteria. We must apply for and obtain the appropriate new licenses before we can implement any plan to expand into a new state or offer a new line of insurance or other new product that requires separate licensing.

The insurance laws of most states in which our insurance subsidiaries operate require insurance companies to file insurance rate schedules and insurance policy forms for review and approval. State insurance regulators have broad discretion in judging whether our rates are adequate, not excessive and not unfairly discriminatory and whether our policy forms comply with law. The speed at which we can change our rates depends, in part, on the method by which the applicable state's rating laws are administered. Generally, state insurance regulators have the authority to disapprove our rates or request changes in our rates. In addition, certain states in which we operate have laws and regulations that limit an automobile insurance company's ability to cancel or not renew policies.

We are subject to state laws and regulations that require diversification of our investment portfolios and that limit the amount of investments in certain categories. Failure to comply with these laws and regulations would cause non-conforming investments to be treated as non-admitted assets for purposes of measuring statutory surplus and, in some instances, would require divestiture.

The state insurance departments that have jurisdiction over our insurance company subsidiaries may conduct on-site visits and examinations of the insurance companies' affairs, especially as to their financial condition, ability to fulfill their obligations to policyholders, market conduct, claims practices and compliance with other laws and applicable

regulations. Typically, these examinations are conducted every three to five years. In addition, if circumstances dictate, regulators are authorized to conduct special or target examinations of insurance companies to address particular concerns or issues. The results of these examinations can give rise to regulatory orders requiring remedial, injunctive or other corrective action on the part of the company that is the subject of the examination or the assessment of fines or other penalties against that company.

The Gramm-Leach-Bliley Act protects consumers from the unauthorized dissemination of certain personal information. The majority of states have implemented additional regulations to address privacy issues. These laws and regulations apply to all financial institutions, including insurance companies, and require us to maintain appropriate procedures for managing and protecting certain personal information of our customers and to fully disclose our privacy practices to our customers. We may also be exposed

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to future privacy laws and regulations, which could impose additional costs and impact our results of operations or financial condition.

In July 2010, the Dodd-Frank Act (the "DFA") was enacted into law. Among other things, the DFA forms within the Treasury Department a Federal Insurance Office ("FIO") that is charged with monitoring all aspects of the insurance industry, gathering data, and conducting a study on methods to modernize and improve the insurance regulatory system in the United States. FIO's report, which was delivered to Congress in 2013, concluded that a hybrid approach to regulation, involving a combination of state and federal government action, could improve the U.S. insurance system by attaining uniformity, efficiency and consistency, particularly with respect to solvency and market conduct regulation. A hybrid approach was also recommended to address the perceived need for uniform supervision of insurance companies with national and global activities. FIO established the Federal Advisory Committee on Insurance ("FACI") whose mission is to provide recommendations to FIO on issues it monitors for Congress. While the NAIC continues to promote the strengths of the U.S. state-based insurance regulatory system, both FIO/FACI and international standard setting authorities such as the International Association of Insurance Supervisors are actively seeking a role in shaping the future of the U.S. insurance regulatory framework.

Title V of the Wall Street Reform Act instructs the FIO Director to submit an update to the report that FIO submitted to Congress in 2013 describing the impact of Part II of the Nonadmitted and Reinsurance Reform Act of 2010 ("NRRRA") on the ability of state regulators to access reinsurance information for regulated entities in their jurisdictions. The update, submitted by FIO in May 2015, concludes that Part II of NRRRA has not had an adverse impact on the ability of state regulators to access reinsurance information from regulated companies. It is not yet known whether or how these organizations' recommendations might result in changes to the current state-based system of insurance industry regulation or ultimately impact Kingsway's operations.

Vehicle service agreements are regulated in all states in the United States, and IWS is subject to these regulations. Most states utilize the approach of the Uniform Service Contract Act which was adopted by the NAIC in the early 1990's. Under that scheme, states regulate vehicle service contract companies by requiring them annually to file documentation, together with a copy of the contract of insurance covering their liability under the service contracts, which complies with the particular state's regulatory requirements. IWS is in compliance with the regulations of each state in which it sells vehicle service agreements.

Certain, but not all, states regulate the sale of HVAC and equipment warranty contracts. Trinity is licensed as a service contract provider in those states where it is required.

### EMPLOYEES

At December 31, 2015, we employed 305 personnel supporting our continuing operations, of which 301 were full-time employees.

### ACCESS TO REPORTS

Our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are made available free of charge through our website at [www.kingsway-financial.com](http://www.kingsway-financial.com) as soon as reasonably practicable after such material is electronically filed with, or furnished to, the U.S. Securities and Exchange Commission ("SEC").

### Item 1A. Risk Factors

Most issuers, including Kingsway, are exposed to numerous risk factors that could cause actual results to differ materially from recent results or anticipated future results. The risks and uncertainties described below are those specific to the Company which we currently believe have the potential to be material, but they may not be the only ones we face. If any of the following risks, or any other risks and uncertainties that we have not yet identified or that we currently consider not to be material, actually occur or become material risks, our business, prospects, financial condition, results of operations and cash flows could be materially and adversely affected. Investors are advised to consider these factors along with the other information included in this 2015 Annual Report and to consult any further disclosures Kingsway makes on related subjects in its filings with the SEC.

### FINANCIAL RISK

Kingsway is a holding company, and its operating insurance subsidiaries are subject to dividend restrictions and are required to maintain minimum capital and surplus levels, which could limit our operations and have a material adverse

effect on our financial condition.

Kingsway is a holding company with assets consisting primarily of the capital stock of its subsidiaries. Our operations are and will continue to be limited by the earnings of our subsidiaries and their ability to pay dividends to us. The payment of dividends by our operating insurance subsidiaries is subject to various statutory and regulatory restrictions imposed by the insurance laws of the domiciliary jurisdiction, including Barbados, of each such subsidiary. As a result of operating losses recorded in recent

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years, at this time none of our U.S. insurance subsidiaries is able to declare and pay a dividend to the holding company without prior regulatory approval. The Company expects these restrictions to continue. In the case of other subsidiaries not currently subject to these restrictions, these subsidiaries may be limited in their ability to make dividend payments or advance funds to Kingsway in the future because of the need to support their own capital levels. The inability of our subsidiaries to pay dividends to us could have a material adverse effect on our financial condition. See the "Liquidity and Capital Resources" section of MD&A for a detailed description of the liquidity requirements of the holding company and the regulatory capital requirements of the operating insurance subsidiaries. No assurances can be given that the operating insurance subsidiaries will be able to maintain compliance with these regulatory capital requirements.

We have substantial outstanding debt, which could adversely affect our ability to obtain financing in the future, react to changes in our business and satisfy our obligations.

As of December 31, 2015, we had \$90.5 million principal value of outstanding subordinated debt, in the form of trust preferred debt instruments, with redemption dates beginning in December, 2032. Because of our substantial outstanding debt:

- our ability to engage in acquisitions without raising additional equity or obtaining additional debt financing could be limited;

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions, debt service requirements or general corporate purposes and our ability to satisfy our obligations with respect to our debt may be impaired in the future;

- a large portion of our cash flow must be dedicated to the payment of principal and interest on our debt, thereby reducing the funds available to us for other purposes;

- we are exposed to the risk of increased interest rates because our outstanding subordinated debt, representing \$90.5 million of principal value, bears interest directly related to the London interbank offered interest rate for three-month U.S. dollar deposits ("LIBOR");

- it may be more difficult for us to satisfy our obligations to our creditors, resulting in possible defaults on, and acceleration of, such debt;

- we may be more vulnerable to general adverse economic and industry conditions;

- we may be at a competitive disadvantage compared to our competitors with proportionately less debt or with comparable debt on more favorable terms and, as a result, they may be better positioned to withstand economic downturns;

- our ability to refinance debt may be limited or the associated costs may increase;

- our flexibility to adjust to changing market conditions and ability to withstand competitive pressures could be limited; and

- we may be prevented from carrying out capital spending that is, among other things, necessary or important to our growth strategy and efforts to improve the operating results of our businesses.

Increases in interest rates would increase the cost of servicing our debt and could adversely affect our results of operation.

\$90.5 million principal value of our outstanding debt bears interest directly related to LIBOR. As a result, increases in LIBOR would increase the cost of servicing our debt and could adversely affect our results of operations. As of December 31, 2015, each one percentage point increase in LIBOR would result in an approximately \$0.9 million increase in our annual interest expense.

Our operations are restricted by the terms of our debt indentures, which could limit our ability to plan for or react to market conditions or meet our capital needs.

Our debt indentures contain numerous covenants that may limit our ability, among other things, to make particular types of restricted payments and pay dividends or redeem capital stock. The covenants under our debt agreements could limit our ability to plan for or react to market conditions or to meet our capital needs. No assurances can be given that we will be able to maintain compliance with these covenants.

If we are not able to comply with the covenants and other requirements contained in the debt indentures, an event of default under the relevant debt instrument could occur. If an event of default does occur, it could trigger a default



under our other debt instruments, and the holders of the defaulted debt instrument could declare amounts outstanding with respect to such debt to become immediately due and payable. Upon such an event, our assets and cash flow may not be sufficient to fully repay borrowings under our outstanding debt instruments. In addition, such a repayment under an event of default could adversely affect our liquidity and force us to sell assets to repay borrowings. The Investment and Capital Committee of the Board of Directors closely monitors the debt and capital position and, from time to time, recommends capital initiatives based upon the circumstances of the Company.

KINGSWAY FINANCIAL SERVICES INC.

We may not be able to realize our investment objectives, which could significantly reduce our earnings and liquidity. We depend on our investments, particularly our fixed maturities, for a substantial portion of our liquidity. As of December 31, 2015, the fair value of our investments included \$55.6 million of fixed maturities. Given the low interest rate environment which exists for fixed maturities, a significant increase in investment yields or an impairment of investments that we own could have a material adverse effect on our business, results of operations and financial condition by reducing the fair value of the investments we own, particularly if we were forced to liquidate investments at a loss. The low interest rate environment for fixed maturities which has existed for years also exposes us to reinvestment risk as these investments mature because the funds may be reinvested at rates lower than those of the maturing investments.

Our ability to achieve our investment objectives is affected by general economic conditions that are beyond our control. General economic conditions can adversely affect the markets for interest rate-sensitive instruments, including the extent and timing of investor participation in such markets, the level and volatility of interest rates and, consequently, the fair value of fixed maturities.

In addition, changing economic conditions can result in increased defaults by the issuers of investments that we own. Interest rates are highly sensitive to many factors, including monetary policies, domestic and international economic and political conditions and other factors beyond our control. General economic conditions, stock market conditions and many other factors can also adversely affect the securities markets and, consequently, the fair value of the investments we own. We may not be able to realize our investment objectives, which could reduce our profitability significantly.

A difficult economy generally may materially adversely affect our business, results of operations and financial condition.

An adverse change in market conditions leading to instability in the global credit markets presents additional risks and uncertainties for our business. In particular, deterioration in the public debt markets could lead to investment losses and an erosion of capital in our insurance company subsidiaries as a result of a reduction in the fair value of investments.

Depending on market conditions going forward, we could incur substantial realized and unrealized losses in future periods, which could have an adverse impact on our results of operations and financial condition. We could also experience a reduction in capital in our insurance subsidiaries below levels required by the regulators in the jurisdictions in which they operate. Certain trust accounts and letters of credit for the benefit of related companies and third-parties have been established with collateral on deposit under the terms and conditions of the relevant trust and/or letter of credit agreements. The value of collateral could fall below the levels required under these agreements putting the subsidiary or subsidiaries in breach of the agreements.

Market volatility may also make it more difficult to value certain of our investments if trading becomes less frequent. Disruptions, uncertainty and volatility in the global credit markets may also impact our ability to obtain financing for future acquisitions. If financing is available, it may only be available at an unattractive cost of capital, which would decrease our profitability. There can be no assurance that market conditions will not deteriorate in the near future.

Financial disruption or a prolonged economic downturn may materially and adversely affect our business.

Worldwide financial markets have recently experienced periods of extraordinary disruption and volatility, resulting in heightened credit risk, reduced valuation of investments and decreased economic activity. Moreover, many companies have experienced reduced liquidity and uncertainty as to their ability to raise capital during such periods of market disruption and volatility. In the event that these conditions recur or result in a prolonged economic downturn, our results of operations, financial position and/or liquidity could be materially and adversely affected. These market conditions may affect the Company's ability to access debt and equity capital markets. In addition, as a result of recent financial events, we may face increased regulation. Many of the other risk factors discussed in this Risk Factors section identify risks that result from, or are exacerbated by, financial economic downturn. These include risks related to our investments portfolio, the competitive environment, adequacy of unpaid loss and loss adjustment expenses and regulatory developments.

We have provided a third-party guarantee which could materially adversely affect our business, results of operations and financial condition.

We provided an indemnity and hold harmless agreement to a third-party for customs bonds reinsured by Lincoln General Insurance Company ("Lincoln General") during the time Lincoln General was a subsidiary of ours. This agreement may require us to compensate the third-party if Lincoln General is unable to fulfill its obligations relating to the customs bonds. Our potential exposure under this agreement is not determinable, and no assurances can be given that we will not be required to perform under this agreement in a manner that has a material adverse effect on our business, results of operations and financial condition.

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We have generated net operating loss carryforwards for U.S. income tax purposes, but our ability to use these net operating losses may be limited by our inability to generate future taxable income.

Our U.S. businesses have generated net operating loss ("NOL") carryforwards for U.S. federal income tax purposes of approximately \$849.9 million as of December 31, 2015. These losses can be available to reduce income taxes that might otherwise be incurred on future U.S. taxable income. The utilization of these losses would have a positive effect on our cash flow. Our operations, however, remain challenged, and there can be no assurance that we will generate the taxable income in the future necessary to utilize these losses and realize the positive cash flow benefit.

We have generated NOL carryforwards for U.S. income tax purposes, but our ability to preserve and use these NOLs may be limited or impaired by future ownership changes.

Our ability to utilize the NOL carryforwards after an "ownership change" is subject to the rules of Section 382 of the U.S. Internal Revenue Code of 1986, as amended ("Section 382"). An ownership change occurs if, among other things, the shareholders (or specified groups of shareholders) who own or have owned, directly or indirectly, five (5%) percent or more of the value of our shares or are otherwise treated as five (5%) percent shareholders under Section 382 and the regulations promulgated thereunder increase their aggregate percentage ownership of the value of our shares by more than 50 percentage points over the lowest percentage of the value of the shares owned by these shareholders over a three-year rolling period. In the event of an ownership change, Section 382 would impose an annual limitation on the amount of taxable income we may offset with NOL carryforwards. This annual limitation is generally equal to the product of the value of our shares on the date of the ownership change multiplied by the long-term tax-exempt rate in effect on the date of the ownership change. The long-term tax-exempt rate is published monthly by the Internal Revenue Service. Any unused Section 382 annual limitation may be carried over to later years until the applicable expiration date for the respective NOL carryforwards. In the event an ownership change as defined under Section 382 were to occur, our ability to utilize our NOL carryforwards would become substantially limited. The consequence of this limitation would be the potential loss of a significant future cash flow benefit because we would no longer be able to substantially offset future taxable income with NOL carryforwards. There can be no assurance that such ownership change will not occur in the future.

Expiration of our tax benefit preservation plan may increase the probability that we will experience an ownership change as defined under Section 382.

In order to reduce the likelihood that we would experience an ownership change without the approval of our Board of Directors, our shareholders ratified and approved the tax benefit preservation plan agreement (the "Plan"), dated as of September 28, 2010, between the Company and Computershare Investor Services Inc., as rights agent, for the sole purpose of protecting the NOLs. The Plan expired on September 28, 2013. There can be no assurance that our Board of Directors will recommend to our shareholders that a similar tax benefit preservation plan be approved to replace the expired Plan; furthermore, there can be no assurance that our shareholders would approve any new tax benefit preservation plan were our Board of Directors to present one for shareholder approval. The expiration of the Plan, without a new tax benefit preservation plan, exposes us to certain changes in share ownership which we would not be able to prevent as we would have been able to prevent under the Plan. Such changes in share ownership could trigger an ownership change as defined under Section 382 resulting in restrictions on the use of NOLs in future periods, as discussed above.

#### COMPLIANCE RISK

If we fail to comply with applicable insurance and securities laws or regulatory requirements, our business, results of operations and financial condition could be adversely affected.

As a publicly traded holding company listed on the Toronto and New York Stock Exchanges and which owns several property and casualty insurance subsidiaries, we are subject to numerous laws and regulations. These laws and regulations delegate regulatory, supervisory and administrative powers to federal, provincial or state regulators. Insurance regulations are generally designed to protect policyholders rather than shareholders and are related to matters including:

- rate-setting;
- risk-based capital and solvency standards;
- restrictions on the amount, type, nature, quality and quantity of investments;

the maintenance of adequate provisions for unearned premiums and unpaid loss and loss adjustment expenses;  
restrictions on the types of terms that can be included in insurance policies;  
standards for accounting;  
marketing practices;  
claims-settlement practices;

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the examination of insurance companies by regulatory authorities, including periodic financial and market conduct examinations;

the licensing of insurers and their agents;

limitations on dividends and transactions with affiliates;

approval of certain reinsurance transactions; and

insolvency proceedings.

In light of losses incurred in recent years, Kingsway and its regulated subsidiaries have been subject to intense review and supervision by insurance regulators. Regulators have taken significant steps to protect the policyholders of the companies we own. These steps have included:

requesting additional capital contributions from Kingsway to its insurance subsidiaries; and

requiring more frequent reporting, including with respect to capital and liquidity positions.

These and other actions have made it challenging for the Company to continue to maintain focus on the operation and development of its businesses. The Company does not expect these conditions to change in the foreseeable future.

In light of financial performance and a number of material transactions executed during the year, the Company has been asked to respond to questions from and provide information to regulatory bodies overseeing insurance and/or securities laws in Canada and the United States. The Company has cooperated in all respects with these reviews and has responded to information requests on a timely basis.

Any failure to comply with applicable laws or regulations could result in the imposition of fines or significant restrictions on our ability to do business, which could adversely affect our results of operations or financial condition. In addition, any changes in laws or regulations, including the adoption of consumer initiatives regarding rates charged for automobile or other insurance coverage or claims-handling procedures, could materially adversely affect our business, results of operations and financial condition. It is not possible to predict the future impact of changing federal, state and provincial regulation on our operations, and there can be no assurance that laws and regulations enacted in the future will not be more restrictive than existing laws and regulations.

Our business is subject to risks related to litigation and regulatory actions.

We are a defendant in a number of legal actions relating to our insurance and other business operations. We may from time to time be subject to a variety of legal and regulatory actions relating to our current and past business operations, including, but not limited to:

disputes over coverage or claims adjudication;

disputes regarding sales practices, disclosure, premium refunds, licensing, regulatory compliance and compensation arrangements;

disputes with our agents, producers or network providers over compensation and termination of contracts and related claims;

disputes with taxing authorities regarding our tax liabilities; and

disputes relating to certain businesses acquired or disposed of by us.

In addition, plaintiffs continue to bring new types of legal actions against insurance and related companies. Current and future court decisions and legislative activity may increase our exposure to these types of claims. Multiparty or class action claims may present additional exposure to substantial economic, non-economic or punitive damage awards. The loss of even one of these claims, if it resulted in a significant award or a judicial ruling that was otherwise detrimental, could create a precedent in our industry that could have a material adverse effect on our results of operations and financial condition. This risk of potential liability may make reasonable settlements of claims more difficult to obtain. We cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on our business.

We may be subject to governmental or administrative investigations and proceedings in the context of our highly regulated businesses. We cannot predict the outcome of these investigations, proceedings and reviews, and cannot assure that such investigations, proceedings or reviews or related litigation or changes in operating policies and practices would not materially adversely affect our results of operations and financial condition. In addition, if we were to experience difficulties with our relationship with a regulatory body in a given jurisdiction, it could have a

material adverse effect on our ability to do business in that jurisdiction.

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STRATEGIC RISK

The achievement of our strategic objectives is highly dependent on effective change management.

We have restructured our operating insurance subsidiaries, including exiting states and lines of business, placing subsidiaries into voluntary run-off and terminating managing general agent relationships, with the objective of focusing on core lines of business, creating a more effective and efficient operating structure and focusing on profitability. These actions resulted in changes to our structure and business processes. While these changes are expected to bring us benefits in the form of a more agile and focused business, success is dependent on management effectively realizing the intended benefits. Ineffective change management may result in disruptions to the operations of the business or may cause employees to act in a manner which is inconsistent with our objectives. Any of these events could negatively impact our performance. We may not always achieve the expected cost savings and other benefits of our initiatives.

We may experience difficulty continuing to reduce our holding company expenses while at the same time retaining staff given the significant reduction in size and scale of our businesses.

We have divested a number of subsidiaries and significantly reduced our written premium in the insurance subsidiaries we continue to own. At the same time, we have been downsizing our holding company expense base in an attempt to compensate for the reduction in scale. There can be no assurance that our remaining businesses will produce enough cash flow to adequately compensate and retain staff and to service our other holding company obligations, particularly the interest expense burden of our remaining outstanding debt.

The insurance industry and related businesses in which we operate may be subject to periodic negative publicity which may negatively impact our financial results.

Our products and services are ultimately distributed to individual consumers. From time to time, consumer advocacy groups or the media may focus attention on insurance products and services, thereby subjecting our industry to periodic negative publicity. We also may be negatively impacted if participants in one or more of our markets engage in practices resulting in increased public attention to our businesses. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the property and casualty insurance industry as well as increased litigation. These factors may further increase our costs of doing business and adversely affect our profitability by impeding our ability to market our products and services, requiring us to change our products or services, or by increasing the regulatory burdens under which we operate.

The highly competitive environment in which we operate could have an adverse effect on our business, results of operations and financial condition.

The property and casualty markets in which we operate are highly competitive. We compete with major North American and other insurers, many of which have more financial, marketing and management resources than we do. There may also be other companies of which we are not aware that may be planning to enter the property and casualty insurance industry. Insurers in our markets generally compete on the basis of price, consumer recognition, coverages offered, claims handling, financial stability, customer service and geographic coverage. Although our pricing is influenced to some degree by that of our competitors, we generally believe that it is not in our best interest to compete solely on price. As a result, we are willing to experience from time to time a loss of market share during periods of intense price competition. Our business could be adversely impacted by the loss of business to competitors offering competitive insurance products at lower prices. This competition could affect our ability to attract and retain profitable business.

In our non-standard automobile business, we compete with both large national underwriters and smaller regional companies. Our competitors include other companies that, like us, serve the independent agency market, as well as companies that sell insurance directly to customers. Direct underwriters may have certain competitive advantages over agency underwriters, including increased name recognition, loyalty of the customer base to the insurer rather than to an independent agency and reduced costs to acquire policies.

Additionally, in certain states, government-operated risk plans may provide non-standard automobile insurance products at lower prices than we provide.

From time to time, our markets may also attract competition from new entrants. In some cases, such entrants may, because of inexperience, the desire for new business or for other reasons, price their insurance below the rates that we



believe offer acceptable premiums for the related risk. Further, a number of our competitors, including new entrants to our markets, are developing e-business capabilities which may impact the level of business transacted through our more traditional distribution channels or that may affect pricing in the market as a whole.

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The vehicle service agreement market in which we compete is comprised of a few large companies, which market service agreements to credit unions on a national basis and have significantly more financial, marketing and management resources than we do, as well as several other companies that are somewhat similar in size to IWS that market service agreements to credit unions either on a regional basis or a less robust national basis. There may also be other companies of which we are not aware that may be planning to enter the vehicle service agreement industry. Competitors in our market generally compete on coverages offered, claims handling, customer service, financial stability and, to a lesser extent, price. Larger competitors of ours benefit from added advantages such as industry endorsements and preferred vendor status. We do not believe that it is in our best interest to compete solely on price. Instead, we focus our marketing on the total value experience to the credit union and its member, with an emphasis on customer service. While we historically have been able to adjust our product offering to remain competitive when competitors have focused on price, our business could be adversely impacted by the loss of business to competitors offering vehicle service agreements at lower prices.

Engaging in acquisitions involves risks, and, if we are unable to effectively manage these risks, our business may be materially harmed.

From time to time we engage in discussions concerning acquisition opportunities and, as a result of such discussions, may enter into acquisition transactions.

Acquisitions entail numerous risks, including the following:

- difficulties in the integration of the acquired business;
- assumption of unknown material liabilities, including deficient provisions for unpaid loss and loss adjustment expenses;
- diversion of management's attention from other business concerns;
- failure to achieve financial or operating objectives; and
- potential loss of policyholders or key employees of acquired companies.

We may not be able to integrate or operate successfully any business, operations, personnel, services or products that we may acquire in the future.

Engaging in new business start-ups involves risks, and, if we are unable to effectively manage these risks, our business may be materially harmed.

From time to time we engage in discussions concerning the formation of a new business venture and, as a result of such discussions, may form and capitalize a new business.

New business start-ups entail numerous risks, including the following:

- identification of appropriate management to run the new business;
- understanding the strategic, competitive and marketplace dynamics of the new business and, perhaps, industry;
- establishment of proper financial and operational controls;
- diversion of management's attention from other business concerns; and
- failure to achieve financial or operating objectives.

We may not be able to operate successfully any business, operations, personnel, services or products that we may organize as a new business start-up in the future.

#### OPERATIONAL RISK

Our provisions for unpaid loss and loss adjustment expenses may be inadequate, which would result in a reduction in our net income and might adversely affect our financial condition.

Our provisions for unpaid loss and loss adjustment expenses do not represent an exact calculation of our actual liability but are estimates involving actuarial and statistical projections at a given point in time of what we expect to be the cost of the ultimate settlement and administration of reported and IBNR claims. The process for establishing the provision for unpaid loss and loss adjustment expenses reflects the uncertainties and significant judgmental factors inherent in estimating future results of both reported and IBNR claims and, as such, the process is inherently complex and imprecise. These estimates are based upon various factors, including:

- actuarial projections of the cost of settlement and administration of claims reflecting facts and circumstances then known;
- estimates of future trends in claims severity and frequency;

legal theories of liability;  
variability in claims-handling procedures;

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economic factors such as inflation;

judicial and legislative trends, actions such as class action lawsuits, and judicial interpretation of coverages or policy exclusions; and

the level of insurance fraud.

Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact our ability to accurately assess the risks of the policies that we write.

In addition, there may be significant reporting lags between the occurrence of insured events and the time they are actually reported to us and additional lags between the time of reporting and final settlement of claims.

As time passes and more information about the claims becomes known, the estimates are appropriately adjusted upward or downward to reflect this additional information. Because of the elements of uncertainty encompassed in this estimation process, and the extended time it can take to settle many of the more substantial claims, several years of experience may be required before a meaningful comparison can be made between actual losses and the original provision for unpaid loss and loss adjustment expenses.

We cannot assure that we will not have unfavorable development in the future. In addition, we have in the past, and may in the future, acquire other insurance companies. We cannot assure that the provisions for unpaid loss and loss adjustment expenses of the companies that we acquire are or will be adequate.

In addition, government regulators for our insurance subsidiaries could require that we increase our provisions for unpaid loss and loss adjustment expenses if they determine that our provisions are understated. Such an increase to the provision for unpaid loss and loss adjustment expenses for one of our insurance subsidiaries could cause a reduction in its surplus as regards policyholders, which could adversely affect our ability to sell insurance policies.

Our Insurance Services subsidiaries' deferred service fees may be inadequate, which would result in a reduction in our net income and might adversely affect our financial condition.

Our Insurance Services subsidiaries' deferred service fees do not represent an exact calculation but are estimates involving actuarial and statistical projections at a given point in time of what we expect to be the remaining future revenue to be recognized in relation to our remaining future obligations to provide policy administration and claim-handling services. The process for establishing deferred service fees reflects the uncertainties and significant judgmental factors inherent in estimating the length of time and the amount of work related to our future service obligations. If we amortize the deferred service fees too quickly, we could overstate current revenues which may adversely affect future reported operating results.

As time passes and more information about the remaining service obligations becomes known, the estimates are appropriately adjusted upward or downward to reflect this additional information. We cannot assure that we will not have unfavorable re-estimations in the future of our deferred service fees. In addition, we have in the past, and may in the future, acquire companies which record deferred service fees. We cannot assure that the deferred service fees of the companies that we acquire are or will be adequate.

Our reliance on independent agents can impact our ability to maintain business, and it exposes us to credit risk.

We market and distribute our automobile insurance products through a network of independent agents in the United States. As a result, we rely heavily on these agents to attract new business. They typically represent more than one insurance company, which may expose us to competition within the agencies and, therefore, we cannot rely on their commitment to our insurance products. Loss of all or a substantial portion of the business provided by these intermediaries could have a material adverse effect on our business, results of operations and financial condition.

In accordance with industry practice, our customers sometimes pay the premiums for their policies to agents for remittance to us. These premiums are considered paid when received by the agents and thereafter the customer is no longer liable to us for those amounts, whether or not we have actually received the premiums from the agents.

Consequently, we assume a degree of risk associated with our reliance on independent agents in connection with the settlement of insurance balances.

Our reliance on credit unions can impact our ability to maintain business.

We market and distribute our vehicle service agreements through a network of credit unions in the United States. As a result, we rely heavily on these credit unions to attract new business. While these distribution arrangements tend to be exclusive between us and each credit union, we have competitors which offer similar products exclusively through

credit unions. Loss of all or a substantial portion of our existing credit union relationships could have a material adverse effect on our business, results of operations and financial condition.

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Our reliance on a limited number of warranty and maintenance support clients and customers can impact our ability to maintain business.

We market and distribute our warranty products and equipment breakdown and maintenance support services through a limited number of customers and clients across the United States. Loss of all or a substantial portion of our existing customers and clients could have a material adverse effect on our business, results of operations and financial condition.

Our gross premiums written are derived from the non-standard automobile markets. If the demand for insurance in this market declines, our results of operations could be adversely affected.

For the year ended December 31, 2015, 100.0% of the gross premiums written from our Insurance Underwriting segment were attributable to non-standard automobile insurance. The size of the non-standard automobile insurance market can be affected significantly by many factors outside of our control, such as the underwriting capacity and underwriting criteria of standard automobile insurance carriers, and we may be specifically affected by these factors. Additionally, the non-standard automobile insurance market tends to contract during periods of high unemployment as was experienced in the United States throughout 2011 and 2012. To the extent that the non-standard automobile insurance markets are affected adversely for any reason, our gross premiums written will be disproportionately affected due to our substantial reliance on these insurance markets.

We derive the majority of our non-standard automobile insurance gross premiums written from a few geographic areas, which may cause our business to be affected by catastrophic losses or business conditions in these areas.

Certain jurisdictions, specifically Florida, Texas, Illinois, California, Colorado and Nevada, generated 84.8% of our non-standard automobile insurance gross premiums written during 2015.

Our results of operations may, therefore, be adversely affected by any catastrophic losses in these areas. Catastrophic losses can be caused by a wide variety of events, including earthquakes, hurricanes, tropical storms, tornadoes, wind, ice storms, hail, fires, terrorism, riots and explosions, and their incidence and severity are inherently unpredictable. Catastrophic losses are characterized by low frequency but high severity due to aggregation of losses and could result in adverse effects on our results of operations or financial condition. Our results of operations may also be adversely affected by general economic conditions, competition, regulatory actions or other business conditions that affect losses or business conditions in the specific areas in which we conduct most of our business.

If reinsurance rates rise significantly or reinsurance becomes unavailable or reinsurers are unable to pay amounts due to us, we may be adversely affected.

We purchase reinsurance from third-parties in order to reduce our liability on individual risks. Reinsurance does not relieve us of our primary liability to our insureds. A third-party reinsurer's insolvency, inability or unwillingness to make payments under the terms of a reinsurance treaty could have a material adverse effect on our financial condition or results of operations. As of December 31, 2015, we had \$2.6 million recoverable from third-party reinsurers, including reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses.

The amount and cost of reinsurance available to our insurance companies are subject, in large part, to prevailing market conditions beyond our control. Our ability to provide insurance at competitive premium rates and coverage limits on a continuing basis depends in part upon the extent to which we can obtain adequate reinsurance in amounts and at rates that will not adversely affect our competitive position. We cannot assure that we will be able to maintain our current reinsurance facilities, which generally are subject to annual renewal. If we are unable to renew any of these facilities upon their expiration or to obtain other reinsurance facilities in adequate amounts and at favorable rates, we may need to modify our underwriting practices or reduce our underwriting commitments.

Disruptions or security failures in our information technology systems could create liability for us and/or limit our ability to effectively monitor, operate and control our operations and adversely impact our reputation, business, financial condition, results of operation and cash flows.

Our information technology systems facilitate our ability to monitor, operate and control our operations. Changes or modifications to our information technology systems could cause disruption to our operations or cause challenges with respect to our compliance with laws, regulations or other applicable standards. For example, delays, higher than expected costs or unsuccessful implementation of new information technology systems could adversely impact our operations. In addition, any disruption in or failure of our information technology systems to operate as expected

could, depending on the magnitude of the problem, adversely impact our business, financial condition, results of operation and cash flows, including by limiting our capacity to monitor, operate and control our operations effectively. Failures of our information technology systems could also lead to violations of privacy laws, regulations, trade guidelines or practices related to our customers and employees. If our disaster recovery plans do not work

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as anticipated, or if the third-party vendors to which we have outsourced certain information technology or other services fail to fulfill their obligations to us, our operations may be adversely impacted. Any of these circumstances could adversely impact our reputation, business, financial condition, results of operation and cash flows.

Our success depends on our ability to price accurately the risks we underwrite.

Our results of operation and financial condition depend on our ability to underwrite and set premium rates accurately for a wide variety of risks. Adequate rates are necessary to generate premiums sufficient to pay loss and loss adjustment expenses and other expenses and to earn a profit. To price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate pricing techniques; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, some of which are outside our control, including:

- the availability of reliable data and our ability to properly analyze available data;
- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate pricing techniques; and
- changes in applicable legal liability standards and in the civil litigation system generally.

Consequently, we could underprice risks, which would adversely affect our underwriting results, or we could overprice risks, which would reduce our sales volume and competitiveness. In either case, our results of operation could be materially and adversely affected.

Our results of operation may fluctuate as a result of cyclical changes in the property and casualty insurance industry. Our results of operation are primarily attributable to the property and casualty insurance industry, which as an industry is cyclical in nature and has historically been characterized by soft markets followed by hard markets. A soft market is a period of relatively high levels of price competition, less restrictive underwriting standards and generally low premium rates. A hard market is a period of capital shortages resulting in lack of insurance availability, relatively low levels of competition, more selective underwriting of risks and relatively high premium rates. If we find it necessary to reduce premiums or limit premium increases due to competitive pressures on pricing in a softening market, we may experience a reduction in our premiums written and, therefore, in our earned premium revenues, which could adversely affect our results of operation.

Our results of operation and financial condition could be adversely affected by the results of our voluntary run-off of two of our insurance subsidiaries.

The Company currently has two of its insurance subsidiaries, MCC and Amigo, operating in voluntary run-off. Our success at managing these run-offs is highly dependent upon proper claim-handling and the availability of the necessary liquidity to pay claims when due. As a result, we are dependent in part on our ability to retain the services of appropriately trained and supervised claim-handling personnel. The loss of the services of any of our key claim-handling personnel working in our run-offs, or the inability to identify, hire and retain other highly qualified claim-handling personnel in the future, could adversely affect our results of operations. We are also dependent on the continuing availability of the necessary liquidity, from the sale of securities, collection of reinsurance recoverables and, potentially, capital contributions, to properly settle claims. Our inability to sell securities when needed or to collect outstanding reinsurance recoverables when due could have an adverse effect on our results of operation or financial condition. See the "Liquidity and Capital Resources" section of MD&A for additional detail regarding the voluntary run-offs of MCC and Amigo.

#### HUMAN RESOURCES RISK

Our business depends upon key employees, and if we are unable to retain the services of these key employees or to attract and retain additional qualified personnel, our business may be adversely affected.

Our success at improving our performance will be dependent in part on our ability to retain the services of our existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of any of our key employees, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect our results of operations.

Item 1B. Unresolved Staff Comments

None.





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Item 2. Properties

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Leased Properties

Insurance Underwriting leases facilities with an aggregate square footage of approximately 75,810 at four locations in four states. The latest expiration date of the existing leases is in November 2019.

Insurance Services leases facilities with an aggregate square footage of approximately 20,636 at four locations in two states. The latest expiration date of the existing leases is in November 2019.

The Company leases facilities for its corporate offices with an aggregate square footage of approximately 8,996 at two locations in one state. The latest expiration date of the existing leases is in September 2025.

The properties described above are in good condition. We consider our office facilities suitable and adequate for our current levels of operations.

Item 3. Legal Proceedings

In connection with its operations in the ordinary course of business, the Company and its subsidiaries are named as defendants in various actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the loss, or range of loss, if any, that may be incurred in connection with any of the various proceedings at this time, it is possible that some of the actions may result in losses having a material adverse effect on the Company's financial condition or results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

## KINGSWAY FINANCIAL SERVICES INC.

## Part II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Market Information

Our common shares are listed on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") under the trading symbol "KFS."

The following table sets forth, for the calendar quarters indicated, the high and low sales price for our common shares as reported on the TSX and NYSE.

	TSX High - C\$	Low - C\$	NYSE High - US\$	Low - US\$
2015				
Quarter 4	C\$6.51	C\$5.43	\$4.90	\$4.09
Quarter 3	7.62	5.95	5.97	4.43
Quarter 2	7.62	6.69	6.12	5.47
Quarter 1	7.49	6.44	5.94	5.41
2014				
Quarter 4	7.30	6.05	6.40	5.40
Quarter 3	7.55	6.41	6.91	6.00
Quarter 2	7.30	4.82	6.69	4.33
Quarter 1	4.88	4.15	4.32	3.85

## Shareholders of Record

As of March 9, 2016, the closing sales price of our common shares as reported by the TSX was C\$5.41 per share and as reported by the NYSE was \$4.18 per share.

As of March 10, 2016, we had 19,709,706 common shares issued and outstanding, held by approximately 3,800 shareholders of record.

## Dividends

The Company has not declared a dividend since the first quarter of 2009. The declaration and payment of dividends is subject to the discretion of our Board of Directors after taking into account many factors, including financial condition, results of operations, anticipated cash needs and other factors deemed relevant by our Board of Directors. For a discussion of our cash resources and needs, see the "Liquidity and Capital Resources" section of MD&A.

We are a holding company and a legal entity separate and distinct from our operating subsidiaries. As a holding company without significant operations of our own, our principal sources of funds are dividends or other payments from our non-insurance subsidiaries as well as the sale of assets held by the holding company and the issuance of securities to raise capital. Dividends declared and paid by an insurance subsidiary are subject to certain restrictions which may require prior approval by the insurance regulators of the state in which such subsidiary is domiciled. At December 31, 2015, the U.S. insurance subsidiaries of the Company were restricted from making any dividend payments to the holding company without regulatory approval pursuant to the domiciliary state insurance regulations. There are no regulatory restrictions on the payment of dividends from the businesses which comprise Insurance Services.

## Securities Authorized for Issuance under Equity Compensation Plans

As of December 31, 2015, we had one equity compensation plan under which our shares of common stock have been authorized for issuance to key officers of the Company and its subsidiaries, namely our 2013 Equity Incentive Plan (the "2013 Plan") adopted by the Board of Directors in 2013. The 2013 Plan has been approved by the shareholders of the Company.

## KINGSWAY FINANCIAL SERVICES INC.

The following summary information is presented with respect to shares of our common stock that may be issued under our equity compensation plans as of December 31, 2015:

## Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
(a)	(b)	(c)	(c)
Equity compensation plans approved by security holders	611,875	\$4.50	40,000
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	611,875	\$4.50	40,000

## Recent Sales of Unregistered Securities

During 2015, we did not have any unregistered sales of our equity securities.

## Repurchases of Equity Securities

During 2015, we did not have any repurchases of our equity securities.

## Item 6. Selected Financial Data

We are a smaller reporting company as defined in Rule 12b-2 of the Exchange Act; therefore, pursuant to Regulation S-K, we are not required to make disclosures under this Item.

KINGSWAY FINANCIAL SERVICES INC.  
Management's Discussion and Analysis

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Kingsway is a Canadian holding company with operating subsidiaries located in the United States. The Company operates as a merchant bank primarily engaged, through its subsidiaries, in the property and casualty insurance business. Kingsway conducts its business through the following two reportable segments: Insurance Underwriting and Insurance Services.

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company ("Mendota"), Mendakota Insurance Company ("Mendakota"), Mendakota Casualty Company (formerly Universal Casualty Company) ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation. Throughout this 2015 Annual Report, the term "Insurance Underwriting" is used to refer to this segment. Insurance Underwriting provides non-standard automobile insurance to individuals who do not meet the criteria for coverage by standard automobile insurers. Insurance Underwriting has policyholders in 12 states; however new business is accepted in only nine states. In 2015, production in the following states represented 84.8% of Insurance Underwriting's gross premiums written: Florida (24.0%), Texas (16.3%), Illinois (15.7%), California (10.3%), Nevada (9.9%) and Colorado (8.6%). For the year ended December 31, 2015, non-standard automobile insurance accounted for 100.0% of Insurance Underwriting's gross premiums written.

The Company previously placed Amigo and MCC into voluntary run-off in 2012 and 2011, respectively. Each of Amigo and MCC entered into a comprehensive run-off plan which was approved by its respective state of domicile. Kingsway continues to manage Amigo and MCC in a manner consistent with the run-off plans. During the first quarter of 2015, MCC sent a letter of intent to the Illinois Department of Insurance to resume writing private passenger automobile policies in the state of Illinois. MCC began writing these policies on April 1, 2015.

Insurance Services includes the following subsidiaries of the Company: IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity"). Throughout this 2015 Annual Report, the term "Insurance Services" is used to refer to this segment.

IWS is a licensed motor vehicle service agreement company and is a provider of after-market vehicle protection services distributed by credit unions in 26 states to their members.

Trinity is a provider of warranty products and maintenance support to consumers and businesses in the heating, ventilation, air conditioning ("HVAC"), standby generator, commercial LED lighting and refrigeration industries. Trinity distributes its warranty products through original equipment manufacturers, HVAC distributors and commercial and residential contractors. Trinity distributes its maintenance support direct through corporate owners of retail spaces throughout the United States.

Effective April 1, 2015, the Company closed on the sale of its wholly owned subsidiary, Assigned Risk Solutions Ltd. ("ARS"). As a result, ARS has been classified as discontinued operations and the results of their operations are reported separately for all periods presented. Prior to the transaction, ARS was included in the Insurance Services segment. As a result of classifying ARS as a discontinued operation, all segmented information has been restated to exclude ARS from the Insurance Services segment.

Effective March 31, 2014, the Company's wholly owned subsidiary, 1347 Property Insurance Holdings, Inc. ("PIH"), formerly known as Maison Insurance Holdings, Inc., completed an initial public offering of its common stock. Upon completion of the transaction, the Company maintained a minority ownership interest in the common shares of PIH. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. Prior to the transaction, PIH was included in the Insurance Underwriting segment. As a result of the disposal of the Company's majority interest in PIH on March 31, 2014, all segmented information has been restated to exclude PIH from the Insurance Underwriting segment.

NON U.S.-GAAP FINANCIAL MEASURES

Throughout this 2015 Annual Report, we present our operations in the way we believe will be most meaningful, useful and transparent to anyone using this financial information to evaluate our performance. In addition to the U.S. GAAP presentation of net income (loss), we show certain statutory reporting information and other non-U.S. GAAP financial measures that we believe are relevant in managing our business and drawing comparisons to our peers. These measures are segment operating (loss) income, gross premiums written, net premiums written and underwriting ratios. Following is a list of non-U.S. GAAP measures found throughout this report with their definitions, relationships to U.S. GAAP measures and explanations of their importance to our operations.

KINGSWAY FINANCIAL SERVICES INC.

Management's Discussion and Analysis

Segment Operating (Loss) Income

Segment operating (loss) income represents one measure of the pretax profitability of our segments and is derived by subtracting direct segment expenses from direct segment revenues. Revenues and expenses are presented in the consolidated statements of operations, but are not subtotaled by segment. However, this information is available in total and by segment in Note 22, "Segmented Information," to the Consolidated Financial Statements, regarding reportable segment information. The nearest comparable U.S. GAAP measure is loss from continuing operations before income tax expense (benefit) which, in addition to operating (loss) income, includes net investment income, net realized gains, other-than-temporary impairment loss, other income not allocated to segments, general and administrative expenses, amortization of intangible assets, contingent consideration benefit, impairment of asset held for sale, interest expense, foreign exchange losses, net, (gain) loss on change in fair value of debt, loss on disposal of subsidiary, loss on disposal of asset held for sale, loss on deconsolidation of subsidiary and equity in net loss of investee. A reconciliation of segment operating (loss) income to loss from continuing operations before income tax expense (benefit) for the year ended December 31, 2015 is presented in Table 1 of the "Results of Continuing Operations" section of MD&A.

Gross Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the consolidated statements of operations, gross premiums written is the component of net premiums earned that measures insurance business produced before the impact of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an overall gauge of gross business volume in Insurance Underwriting.

Net Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the consolidated statements of operations, net premiums written is the component of net premiums earned that measures the difference between gross premiums written and the impact of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an indication of retained or net business volume in Insurance Underwriting.

Underwriting Ratios

Kingsway, like many insurance companies, analyzes performance based on underwriting ratios such as loss and loss adjustment expense ratio, expense ratio and combined ratio. The loss and loss adjustment expense ratio is derived by dividing the amount of net loss and loss adjustment expenses incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions and premium taxes; general and administrative expenses and policy fee income by net premiums earned. The combined ratio is the sum of the loss and loss adjustment expense ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates an underwriting loss.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect application of policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates. Estimates and their underlying assumptions are reviewed on an ongoing basis. Changes in estimates are recorded in the accounting period in which they are determined. The critical accounting estimates and assumptions in the accompanying consolidated financial statements include the provision for unpaid loss and loss adjustment expenses; valuation of fixed maturities and equity investments; valuation of deferred income taxes; impairment assessment of intangible assets; goodwill recoverability; deferred acquisition costs; fair value assumptions for performance shares; fair value assumptions for debt obligations; and contingent consideration.

Provision for Unpaid Loss and Loss Adjustment Expenses



A significant degree of judgment is required to determine amounts recorded in the consolidated financial statements for the provision for unpaid loss and loss adjustment expenses. The process for establishing the provision for unpaid loss and loss adjustment expenses reflects the uncertainties and significant judgmental factors inherent in predicting future results of both known and unknown loss events. As such, the process is inherently complex and imprecise and estimates are constantly refined. The process of establishing the provision for unpaid loss and loss adjustment expenses relies on the judgment and opinions of a large number of individuals, including the opinions of the Company's actuaries. Further information regarding estimates used in determining our provision for unpaid loss and loss adjustment expenses is discussed in the "Unpaid Loss and Loss Adjustment Expenses" section of Part I, Item 1 of this Annual Report and Note 12, "Unpaid Loss and Loss Adjustment Expenses," to the Consolidated Financial Statements.

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Factors affecting the provision for unpaid loss and loss adjustment expenses include the continually evolving and changing regulatory and legal environment; actuarial studies; the professional experience and expertise of the Company's claims 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 loss settlement costs; court decisions; economic conditions; and public attitudes.

The Company utilizes external actuaries to evaluate the adequacy of our provision for unpaid loss and loss adjustment expenses under the terms of our insurance policies and vehicle service agreements. The provision is evaluated by the Company's actuaries with the results then shared with management, which is responsible for establishing the provision recorded in the consolidated balance sheets.

In the year-end actuarial review process, an analysis of the provision for unpaid loss and loss adjustment expenses is completed for each insurance subsidiary and IWS. Unpaid deferred cost containment expenses and unpaid adjusting and other expenses, which are components of the provision for loss adjustment expenses, and unpaid losses are each separately analyzed by line of business and by accident year utilizing a wide range of actuarial methods. These unpaid losses and loss adjustment expenses are further analyzed by looking separately at case reserves, which are specific reserves established for specific claims, and reserves for losses incurred but not reported ("IBNR").

Because the establishment of the provision for unpaid loss and loss adjustment expenses is an inherently uncertain process involving estimates, current provisions may need to be updated. Adjustments to the provision, both favorable and unfavorable, are reflected in the consolidated statements of operations for the periods in which such estimates are updated. The Company's actuaries develop a range of reasonable estimates and a point estimate of unpaid loss and loss adjustment expenses. The actuarial point estimate is intended to represent the actuaries' best estimate and will not necessarily be at the mid-point of the high and low estimates of the range.

#### Valuation of Fixed Maturities and Equity Investments

Our equity investments, including warrants, are recorded at fair value using quoted market values based on latest bid prices, where active markets exist, or models based on significant market observable inputs, where no active markets exist. For fixed maturities, we use observable inputs such as quoted prices in inactive markets, quoted prices in active markets for similar instruments, benchmark interest rates, broker quotes and other relevant inputs. We do not have any investments in our portfolio which require us to use unobservable inputs. Any change in the estimated fair value of our investments could impact the amount of unrealized gain or loss we have recorded, which could change the amount we have recorded for our investments and other comprehensive income (loss) on our consolidated balance sheets.

Gains and losses realized on the disposition of investments are determined on the first-in first-out basis and credited or charged to the consolidated statements of operations. Premium and discount on investments are amortized and accredited using the interest method and charged or credited to net investment income.

The establishment of an other-than-temporary impairment on an investment requires a number of judgments and estimates. We perform a quarterly analysis of the individual investments to determine if declines in market value are other-than-temporary. The analysis includes some or all of the following procedures, as applicable:

- identifying all unrealized loss positions that have existed for at least six months;
- identifying other circumstances which management believes may impact the recoverability of the unrealized loss positions;
- obtaining a valuation analysis from third-party investment managers regarding the intrinsic value of these investments based on their knowledge and experience together with 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 instruments based on the investment grade credit ratings from third-party rating agencies;
- assessing if declines in market value are other-than-temporary for any debt instrument with a 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 investments at least until the investment impairment is recovered.

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

the opinions of professional investment managers could be incorrect;

KINGSWAY FINANCIAL SERVICES INC.

Management's Discussion and Analysis

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 instruments may not reflect future debt service capabilities and may not reflect a company's unknown underlying financial problems.

As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, the Company recorded a write down of \$0.0 million for other-than-temporary impairment related to fixed maturities for the year ended December 31, 2015. The Company did not recognize any impairment related to its investments that was considered other-than-temporary for the year ended December 31, 2014.

Valuation of Deferred Income Taxes

The provision for income taxes is calculated based on the expected tax treatment of transactions recorded in our consolidated financial statements. In determining our provision for income taxes, we interpret tax legislation in a variety of jurisdictions and make assumptions about the expected timing of the reversal of deferred income tax assets and liabilities and the valuation of deferred income taxes.

The ultimate realization of the deferred income tax asset balance is dependent upon the generation of future taxable income during the periods in which the Company's temporary differences reverse and become deductible. A valuation allowance is established when it is more likely than not that all or a portion of the deferred income tax asset balance will not be realized. In determining whether a valuation allowance is needed, management considers all available positive and negative evidence affecting specific deferred income tax asset balances, including the Company's past and anticipated future performance, the reversal of deferred income tax liabilities, and the availability of tax planning strategies.

Objective positive evidence is necessary to support a conclusion that a valuation allowance is not needed for all or a portion of a company's deferred income tax asset balances when significant negative evidence exists. Cumulative losses are the most compelling form of negative evidence considered by management in this determination. To the extent a valuation allowance is established in a period, an expense must be recorded within the income tax provision in the consolidated statements of operations. As of December 31, 2015, the Company maintains a valuation allowance of \$283.6 million, \$277.1 million of which relates to its U.S. deferred income taxes. The largest component of the U.S. deferred income tax asset balance relates to tax loss carryforwards that have arisen as a result of losses generated from the Company's U.S. operations. Uncertainty over the Company's ability to utilize these losses over the short-term has led the Company to record a valuation allowance.

Future events may result in the valuation allowance being adjusted, which could materially impact our financial position and results of operations. If sufficient positive evidence were to arise in the future indicating that all or a portion of the deferred income tax assets would meet the more likely than not standard, the valuation allowance would be reversed in the period that such a conclusion was reached.

Impairment Assessment of Intangible Assets

Intangible assets are recorded at their estimated fair values at the date of acquisition. Intangible assets with definite useful lives consist of vehicle service agreements in-force ("VSA in-force"), database and customer-related relationships. Intangible assets with definite useful lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. If circumstances require that a definite-lived intangible asset be tested for possible impairment, we first compare the undiscounted cash flows expected to be generated by that definite-lived intangible asset to its carrying amount. If the carrying amount of the definite-lived intangible asset is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying amount exceeds its fair value.

Indefinite-lived intangible assets consist of insurance licenses and trade name. Intangible assets with an indefinite life are assessed for impairment annually as of December 31, or more frequently if events or circumstances indicate that the carrying value may not be recoverable. The Company has the option to perform a qualitative assessment to

determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. If facts and circumstances indicate that it is more likely than not that the intangible asset is impaired, a fair value-based impairment test would be required. Management must make estimates and assumptions in determining the fair value of indefinite-lived intangible assets that may affect any resulting impairment write-down. This includes assumptions regarding future cash flows and future revenues from the related intangible assets or their reporting units. Management then compares the fair value of the indefinite-lived intangible assets to their respective carrying amounts. If the carrying amount of an intangible asset exceeds the fair value of that intangible asset, an impairment is recorded.

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Additional information regarding our intangible assets is included in Note 10, "Intangible Assets," to the Consolidated Financial Statements.

Goodwill Recoverability

Goodwill is assessed for impairment annually as of December 31, or more frequently if events or circumstances indicate that the carrying value may not be recoverable. The Company has the option to perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If facts and circumstances indicate that it is more likely than not that the goodwill is impaired, a fair value-based impairment test would be required. The goodwill impairment test is a two-step process that requires management to make judgments in determining what assumptions to use in the calculation. The first step of the process consists of estimating the fair value of each reporting unit based on valuation techniques, including a discounted cash flow model using revenue and profit forecasts, and comparing those estimated fair values with the carrying values of the assets and liabilities of the reporting unit, which includes the allocated goodwill. If the estimated fair value is less than the carrying value, a second step is performed to compute the amount of the impairment, if any, by determining an implied fair value of goodwill. The determination of the implied fair value of goodwill of a reporting unit requires management to allocate the estimated fair value of the reporting unit to the assets and liabilities of the reporting unit. Any unallocated fair value represents the implied fair value of goodwill, which is compared to its corresponding carrying value. For reporting units with a negative book value, qualitative factors are evaluated to determine whether it is necessary to perform the second step of the goodwill impairment test. Additional information regarding our goodwill is included in Note 9, "Goodwill," to the Consolidated Financial Statements.

Deferred Acquisition Costs

Deferred acquisition costs represent the deferral of expenses that we incur related to successful efforts to acquire new business or renew existing business. Acquisition costs, primarily commissions, premium taxes and underwriting and agency expenses related to issuing insurance policies and vehicle service agreements, are deferred and charged against income ratably over the terms of the related insurance policies and vehicle service agreements. Management regularly reviews the categories of acquisition costs that are deferred and assesses the recoverability of this asset. For Insurance Underwriting, a premium deficiency and a corresponding charge to income is recognized if the sum of the expected losses and loss adjustment expenses, unamortized acquisition costs and maintenance costs exceeds related unearned premiums and anticipated net investment income.

Derivative Financial Instruments

Derivative financial instruments include investments in warrants and performance shares issued to the Company under various performance share grant agreements. Refer to Note 24, "Related Party Transactions," to the Consolidated Financial Statements, for further details regarding the performance shares. Warrants are classified as equity investments in the consolidated balance sheets.

We measure derivative financial instruments at fair value. Warrants are recorded at fair value using quoted market values based on latest bid prices, where active markets exist, or models based on significant market observable inputs, where no active markets exist. The performance shares, for which no active market exists, are required to be valued at fair value as determined in good faith by the Company. Such determination of fair value would require us to develop a model based upon relevant observable market inputs as well as significant unobservable inputs, including developing a sufficiently reliable estimate for an appropriate discount to reflect the illiquidity and unique structure of the security. The Company determined that its model for the performance shares was not sufficiently reliable. As a result, we have assigned a fair value of zero to the performance shares. The fair value of derivative financial instruments is required to be revalued each reporting period, with corresponding changes in fair value recorded in the consolidated statements of operations, or, in the case of derivative financial instruments that are actively traded, in other comprehensive income (loss). Realized gains or losses are recognized upon settlement of the contracts.

Fair Value Assumptions for Debt Obligations

Our Linked Return of Capital ("LROC") preferred units due June 30, 2015 and subordinated debt are measured and reported at fair value. The fair value of the LROC preferred units was based on quoted market prices prior to redemption in June 2015, and the fair value of the subordinated debt is calculated by a third-party using a model based on significant market observable inputs. Any change in the estimated fair value of our debt is reflected in the gain or loss on change in fair value of debt we record in the consolidated statements of operations and in the carrying value for our debt on our consolidated balance sheets.

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Contingent Consideration

The consideration for certain of the Company's acquisitions includes future payments to the former owners that are contingent upon the achievement of certain targets over future reporting periods. Liabilities for contingent consideration are measured and reported at fair value at the date of acquisition with subsequent changes reported in the consolidated statements of operations as contingent consideration benefit or expense. The fair value of contingent consideration liabilities is estimated using valuation models designed to estimate the probability of such contingent payments based on various assumptions. Estimated payments are discounted using present value techniques to arrive at the estimated fair value at the balance sheet date. We revalue these contingent consideration liabilities each reporting period. Changes in the fair value of contingent consideration liabilities can result from changes to one or multiple inputs, including adjustments to the discount rates or changes in the assumed achievement or timing of any targets. These fair value measurements are based on significant inputs not observable in the market. Management must use judgment in determining the appropriateness of these assumptions as of the acquisition date and for each subsequent period. Changes in assumptions could have a material impact on the amount of contingent consideration benefit or expense reported in the consolidated statements of operations and an impact on the payout of contingent consideration liabilities. Additional information regarding our contingent consideration liabilities is included in Note 23, "Fair Value of Financial Instruments," to the Consolidated Financial Statements.

RESULTS OF CONTINUING OPERATIONS

A reconciliation of total segment operating (loss) income to net income (loss) for the years ended December 31, 2015 and 2014 is presented in Table 1 below:

Table 1 Segment Operating (Loss) Income

For the years ended December 31 (in thousands of dollars)

	2015	2014	Change
Segment operating (loss) income			
Insurance Underwriting	(1,147	) 1,290	(2,437 )
Insurance Services	(628	) 206	(834 )
Total segment operating (loss) income	(1,775	) 1,496	(3,271 )
Net investment income	2,918	1,616	1,302
Net realized gains	1,197	5,041	(3,844 )
Other-than-temporary impairment loss	(10	) —	(10 )
Other income and expenses not allocated to segments, net	(3,753	) (4,887	) 1,134
Amortization of intangible assets	(1,244	) (1,620	) 376
Contingent consideration benefit	1,139	2,223	(1,084