U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 40-F

[Check one]
[ ] **Registration Statement Pursuant to Section 12 of the Securities Exchange Act of 1934**
or
[X] **Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended: **December 31, 2005** Commission File Number: 1-15212

KINGSWAY FINANCIAL SERVICES INC.

(Exact name of Registrant as specified in its charter)

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

5310 Explorer Drive, Suite 200, Mississauga, Ontario, Canada L4W 5H8
(905) 629-7888

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

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

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

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

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

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

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

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

[X] Annual information form [X] Audited annual financial statements

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

56,480,453 Common Shares outstanding as of December 31, 2005

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

Yes ____ 82-____ No __X__

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes __X__ No ___

KINGSWAY FINANCIAL SERVICES INC.

DOCUMENTS FILED UNDER COVER OF THIS FORM

Item	**Description**	**Sequential Page Number**
1.	Annual Information Form dated March 31, 2006 for the year ended December 31, 2005.	3
2.	Audited Consolidated Financial Statements of the Registrant for the fiscal years ended December 31, 2005 and 2004, including a reconciliation of U.S.and Canadian generally accepted accounting principles.	20
3.	Management s Discussion and Analysis of Financial Condition and Results of Operations.	76

Document No. 1

KINGSWAY FINANCIAL SERVICES INC.

2005 ANNUAL INFORMATION FORM

March 31, 2006

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1. INCORPORATION

Kingsway Financial Services Inc. (KFSI) was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. On November 10, 1995, KFSI filed articles of amendment deleting its private company share restrictions, subdividing KFSI s outstanding common shares on a three for one basis, and deleting the Class A Special Shares and the Class B Special Shares that were previously authorized. On October 11, 1996, KFSI filed articles of amendment to sub-divide the common shares on a two for one basis. On April 27, 1998, KFSI filed articles of amendment to subdivide the common shares on a two for one basis. The principal and registered office of KFSI is located at 5310 Explorer Drive, Suite 200, Mississauga, Ontario, L4W 5H8.

2. INTER-CORPORATE RELATIONSHIPS

KFSI s material subsidiaries and their intercorporate relationship with KFSI as of the most recent financial year end are listed and described in Note 2(a) to the Consolidated Financial Statements of KFSI contained in KFSI s 2005 Annual Report (the Annual Report) which is incorporated herein by reference. All subsidiaries are 100% owned, directly or indirectly, (except for qualifying shares of York Fire & Casualty Insurance Company and Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements).

3. GENERAL DEVELOPMENT OF THE BUSINESS

KFSI is a holding company which operates through its wholly owned subsidiaries in the property and casualty insurance business. Since its inception in 1986, Kingsway General Insurance Company (KGIC) has provided property and casualty insurance in specialized lines in Canada, primarily in the automobile insurance market. In 1989, KGIC became a wholly owned subsidiary of KFSI. Since KFSI s initial public offering in 1995, KFSI has made selective acquisitions in Canada and the United States, including its insurance subsidiaries, American Service Insurance Company, Inc., U.S. Security Insurance Company, Jevco Insurance Company (Jevco), Southern United Fire Insurance Company, Universal Casualty Company, Lincoln General Insurance Company, York Fire & Casualty Insurance Company, American Country Insurance Company, and Zephyr Insurance Company Inc. (Zephyr). In addition, insurance subsidiaries have developed specific books of business by entering into contracts with program managers. All of the dollar amounts are expressed in U.S. dollars, except where otherwise indicated. References to C$ are to Canadian dollars.

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

(a) the completion in May 2003 of a private placement of $17.5 million in 30-year floating rate trust preferred securities;

(b) the completion in May 2003 of a private placement of $15 million in 30-year floating rate trust preferred securities;

(c) the completion in July 2003 of a public offering only in Canada of 6,710,000 common shares at a price of C$16.70 per share resulting in total gross proceeds of C$112,100,000;

(d) the completion in September 2003 of a private placement of $10 million in 30 year floating rate trust preferred securities;

(e) the completion in October 2003 of a private placement of $20 million in 30 year floating rate trust preferred securities;

(f) the completion in December 2003 of a private placement of $13 million in 30 year floating rate trust preferred securities;

(g) the completion in January 2004 of a private placement of $100 million in 10 year 7.5% senior notes and the completion in March 2004 of the sale of an additional $25 million of the 10-year 7.5% senior notes;

(h) the C$150 million syndicated unsecured revolving credit facility in March 2004, the renewal of that credit facility in December 2004 and the replacement of that facility with a C$150 million syndicated unsecured revolving credit facility in February, 2006;

(i) the completion of two quota share reinsurance agreements effective April 2004 permitting Lincoln General Insurance Company and Kingsway General Insurance Company to cede a variable amount of premiums to reinsurers rated A+ or better by AM Best which agreements expired and were not renewed in 2005;

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

(k) the closing in October 2005 of the acquisition of HI Holdings, Inc. (HI) for approximately $25 million, which includes HI s wholly owned Zephyr Insurance Company Inc.; and

(l) the completion, in November, 2005 of a program management agreement between Lincoln General Insurance Company with The Robert Plan Corporation which provides that the KFSI affiliate will assume risk relating to assigned risk obligations acquired from other insurers.

4. <u>NARRATIVE DESCRIPTION OF THE BUSINESS</u>

Commercial trucking insurance has become the largest segment of Kingsway s business. KFSI is considered to be the largest trucking insurer in North America. This line of business comprised 31% of KFSI s gross premiums written (**GPW**) (the total premiums on insurance underwritten before deduction of reinsurance premiums ceded) in 2005.

In 2005, non-standard automobile business accounted for 29% of KFSI s $1,894.7 million of GPW. Non-standard automobile insurance is the insuring of automobile risks for drivers with worse than average driving records primarily as a result of accidents or traffic violations.

KFSI s premium distribution by line and geographic areas is set out in Note 12 to the Consolidated Financial Statements contained in the Annual Report which is incorporated herein by reference.

In addition to revenue derived from premiums earned, KFSI also derives revenue from premium financing and investment income. This revenue amounted to $131.2 million in 2005 as compared to $94.7 million in 2004.

KFSI strives to remain a disciplined underwriter. KFSI has earned a profit from its underwriting activities for 13 of the last 16 fiscal years, including 7 of the last 10 years. The selected Supplemental Financial Information set out on page 77 of the Annual Report, which is incorporated herein by reference, provides details of the gross premiums written, underwriting profits, and key ratios from KFSI s insurance operations compared to industry results for the eight year period ending December 31, 2005 and are incorporated herein by reference.

<u>Employees</u>

As at December 31, 2005, KFSI employed an aggregate of approximately 2,300 personnel, none of whom are unionized.

<u>Liquidity</u>

Capital required for KFSI s business has been obtained from KFSI s public offerings of common shares and debt securities, its syndicated term and operating lending facilities, the issuance of trust preferred securities and has been internally generated from underwriting and investment profits. KFSI s operations create liquidity by collecting and investing premiums, as more fully discussed on page 42 of the Annual Report, which are incorporated by reference herein.

Investment Portfolio

The fair value of the investment portfolio increased from $2,644.1 million at the end of 2004 to $2,933.0 million at December 31, 2005. Returns on a pre-tax basis were 4.7% for the year compared with 4.0% for 2004. The investment portfolio as at December 31, 2005 and December 31, 2004 is comprised of assets from a number of different classes as reflected in Note 3 to the 2005 Consolidated Financial Statements set out on pages 64 to 66 of the Annual Report, which are incorporated herein by reference.

Competitive Position

The insurance industry is price competitive in all markets in which KFSI's insurance subsidiaries operate. KFSI s subsidiaries strive to employ disciplined underwriting practices with the objective of rejecting underpriced risks. The combined ratio of claims plus underwriting expenses compared to net premiums earned is the traditional measure of underwriting results of property and casualty companies. In any year when the ratio exceeds 100%, it generally indicates that unprofitable business has been underwritten. Through deliberate underwriting, pricing, risk selection, stringent claims management, and non-renewal of unprofitable policies, KFSI has produced an underwriting profit in 13 of the last 16 years.

KFSI believes that it is better to write less business with higher profits than to compete with other insurers at lower premiums to increase volume at the expense of higher combined ratios. As a result of the softening of the market in certain segments and territories during 2005, KFSI s GPW was reduced. In 2005, Kingsway s combined ratio from Canadian and U.S. Operations was 96.1% and 97.7%,respectively, compared with the industry averages of 91.2% and 102.0%, respectively.

5. RISK FACTORS

The risks faced by KFSI are described on pages 47 to 55 of the Annual Report and those pages are incorporated herein by reference.

6. DIVIDEND POLICY

The ability of KFSI to pay dividends is largely dependent upon its ability to receive dividends from its subsidiaries. The insurance subsidiaries are regulated and are required to maintain statutory capital in order to write insurance policies. Regulatory authorities may impose, from time to time, additional restrictions which may affect the actual amounts available to KFSI for the payment of dividends.

During the fiscal years ending December 31, 2003 and 2004, KFSI did not pay any dividends. KFSI paid and declared cash dividends in the aggregate amount of C$0.20 per share for the fiscal year ending December 31, 2005. KFSI has declared a quarterly dividend of C$0.0625 per share payable on March 31, 2006. Any decision to pay dividends on KFSI s common shares in the future will be dependent upon the financial requirements of KFSI to finance future growth, the financial condition of KFSI and other factors which the Board of Directors of KFSI may consider appropriate in the circumstances.

7. DESCRIPTION OF CAPITAL STRUCTURE

(a) Common Shares

General Description of Capital Structure

The authorized capital of KFSI consists of an unlimited number of common shares, of which, as of March 17, 2006, 56,436,154 common shares were outstanding. All common shares have the same attributes, including the right to one vote per share.

Change of Control

Many state insurance laws intended primarily for the protection of policyholders require advance approval by state insurance commissioners of any change in control of an insurance company that is domiciled (or, in some cases, having such substantial business that it is deemed to be commercially domiciled) in that state. Control is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. In addition, insurance laws in many states contain provisions that require prenotification to the insurance commissioners of a change in control of a non-domestic insurance company licensed in those states.

Any future transactions that would constitute a change in control of our U.S. insurance company subsidiaries, including a change of control of KFSI, would generally require the party acquiring control to obtain the prior approval by the insurance departments of the insurance subsidiaries states of domicile or commercial domicile, if any, and may require pre-acquisition notification in applicable states that have adopted pre-acquisition notification provisions. Obtaining these approvals could result in material delay of, or deter, any such transaction.

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

(b) Debt Securities

KFSI has issued C$78 million of 8.25% unsecured senior debentures with a maturity date of December 31, 2007. The debentures are redeemable prior to the maturity date, at KFSI s option, providing at least 30 days notice to debenture holders. Interest on the debentures is payable semi-annually in arrears.

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

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

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

(c) Ratings

The ratings received from rating organizations for securities of KFSI are described on page 44 of the Annual Report and those pages are incorporated herein by reference.

8. MARKET FOR SECURITIES

(a) Trading Price and Volume

The common shares of KFSI are listed on the Toronto Stock Exchange (the TSE) and the New York Stock Exchange (Symbol KFS).

The following chart sets forth the high and low sales price and volume for the common shares of KFSI on the TSE for the periods indicated in Canadian dollars:

Month	High	Low	Volume
January 2005	19.98	18.45	2,583,962
February 2005	21.48	19.05	5,814,040
March 2005	20.20	17.91	3,905,172
April 2005	20.15	18.45	2,370,372
May 2005	20.94	19.51	2,798,163
June 2005	21.80	20.28	2,561,696
July 2005	21.95	21.05	1,219,513
August 2005	22.80	20.60	3,137,429
September 2005	22.00	19.76	1,885,921
October 2005	21.00	18.77	2,629,189
November 2005	21.98	19.34	3,096,894
December 2005	23.62	21.91	1,736,475

(b) Prior Sales

No common shares of KFSI were issued during the fiscal year ending December 31, 2005 except for 270,203 common shares issued on the exercise of options granted pursuant to KFSI s Stock Option Plan.

9. DIRECTORS AND OFFICERS

The following table and the notes thereto state the names of all executive officers of the Corporation, all other positions or offices with the Corporation and its subsidiaries now held by them, their principal occupations or employment and the number of Common Shares and Options of the Corporation beneficially owned, directly or indirectly, by each of them, or over which they exert control or direction as of March 17, 2006. The same information relating to the directors of the Corporation is contained in the Election of Directors section of the Management Information Circular of KFSI dated March 17, 2006, which is incorporated herein by reference.

Name and Municipality of Residence and Present Principal Occupation	Position with the Corporation	Common Shares of the Corporation beneficially owned, directly or indirectly, or controlled or directed	Number of Options Held
William G. Star Mississauga, ON	Chairman, President and Chief Executive Officer, KFSI	416,065	600,000
W. Shaun Jackson Oakville, ON	Executive Vice-President and Chief Financial Officer, KFSI	69,600	320,000
Frank Amodeo	Vice-President, KFSI	5,499	30,000

Toronto, ON			
Dennis Fielding Pickering, ON	Vice-President, KFSI	4,363	31,000
Laura Foster Toronto, ON	Vice-President, Internal Audit, KFSI	1,001	9,000
Shelly Gobin Mississauga, ON	Vice-President and Treasurer, KFSI	36,841	45,167
Claude Smith Cambridge, ON	Vice-President and Chief Information Officer, KFSI	2,159	31,000
Andrew Wright Toronto, ON	Vice-President, Reinsurance and Risk Management, KFSI	500	8,000

Frank Amodeo joined KFSI in July, 2001. Prior thereto, Mr. Amodeo was Vice-President and General Manager of Winterthur International (The Citadel General Assurance Company).

Laura Foster joined KFSI in December, 2003. Prior thereto, Ms. Foster was Assistant Vice President, Corporate Compliance at Canada Life Assurance Company from July, 1998 to August, 2003.

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

Except as noted above, for the past five years each executive officer has been engaged in his current occupation or in other capacities within the same or a related entity.

As a group, the directors and officers of KFSI own, directly or indirectly or exercise control or direction over 721,978 (1.3% of the total outstanding) common shares of KFSI. The information as to shares owned indirectly or over which control or direction is exercised by the directors and officers, but which are not registered in their names, not being within the knowledge of KFSI, has been furnished by such officers of KFSI.

The Corporation does not have an Executive Committee. Mr. Walsh serves as KFSI s lead director. The Board of Directors has established an Audit Committee comprised solely of outside Directors, namely Messrs. Atkins, Di Giacomo, Farnam and Walsh. In addition, the Corporation has an Investment Committee comprised of Messrs. Di Giacomo, Star, Sullivan and Walsh, a Nominating Committee comprised of Messrs. Atkins, Walsh, Reeve and Sullivan, and a Compensation and Management Resources Committee comprised of Messrs. Di Giacomo, Gluckstein, Beamish and Farnam.

10. LEGAL PROCEEDINGS

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

11. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

The Audit Committee reviewed all related party transactions between KFSI and its subsidiaries and the officers and directors of KFSI. The Audit Committee determined that there were no related party transactions that required disclosure under any securities laws other than commissions of approximately C$91,540 paid by a cruise ship operator to a corporation owned by the spouse of the President and Chief Executive Officer of KFSI for an incentive cruise sponsored by KFSI for certain of its brokers.

12. AUDIT COMMITTEE INFORMATION

(a) Composition of the Audit Committee

The Audit Committee of KFSI is composed of the following four members: David H. Atkins, Thomas A. Di Giacomo, Walter E. Farnam and F. Michael Walsh. Mr. Farnam was appointed a member in February, 2006. The responsibilities and duties of the Audit Committee are set out in the Audit Committee s charter, the text of which is set forth in Appendix I to this Annual Information Form.

The Board of Directors believes that the composition of the Audit Committee reflects a high level of financial literacy and expertise. Each member of the Audit Committee has been determined by the Board of Directors to be independent and financially literate as such terms are defined under Canadian and United States securities laws and the NYSE rules. In addition, the Board has determined that Mr. Atkins is an Audit Committee Financial Expert as such term is defined under United States securities laws. The Board has made these determinations based on the education and breadth and depth of experience of each member of the Committee. The following is a description of the education and experience of each member of the Committee that is relevant to the performance of his or her responsibilities as a member of the Audit Committee:

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

Thomas A. Di Giacomo has been the President of Tadico Limited, a business consulting and investment firm since 1994. Prior thereto he held a number of positions at Manulife Financial, the most recent being Chairman of the Board, President and CEO from 1990-1993. Mr. Di Giacomo is the chairman of RDM Corporation and sits on the Board of several companies including Menu Foods Income Fund, Luxell Corporation and Afriore Corporation, all of which companies are listed on the Toronto Stock Exchange.

Walter E. Farnam received a B.A. from Brown University. During his career, Mr. Farnam has held various senior positions in the insurance industry and from 1998 until his retirement in June, 2001 served as Chairman of the Board of the CGU Insurance Group in the United States. Prior to June, 1998 Mr. Farnam was Chairman and Chief Executive Officer of General Accident Insurance in Philadelphia. He also held the position of President and Chief Operating Officer of General Accident Insurance in the United States from July, 1985 through August 1991. He is a Fellow of the Casualty Actuarial Society and is Past Chairman of the Council of Insurance Company Executives. Mr. Farnam also served on the Executive Committee and Board of Trustees of the American Institute for Chartered Property Casualty Underwriters/Insurance Institute of America.

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

(b) Shareholders Auditors Service Fees

Aggregate fees paid to the Shareholders Auditors during the fiscal years ended December 31, 2005 and 2004 were as follows:

(in Canadian dollars)	2005 Fee Amount	2004 Fee Amount
Audit Fees	$2,121,000	$2,064,000
Audit-related Fees	$ 169,000	$ 467,000
Tax Fees	$ 245,000	$ 57,000
All Other Fees	$ 2,000	$ 2,000
Total:	$2,437,000	$2,590,000

13. TRANSFER AGENT AND REGISTRAR

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

14. INTERESTS OF EXPERTS

(a) Names of Experts

KPMG LLP prepared an auditors report in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2005. The Canadian Institute of Chartered Accountants gives authority to the report.

David J. Oakden, of Tillinghast, a business of Towers Perrin, prepared an actuary report in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2005. The Canadian Institute of Actuaries gives authority to the report.

(b) Interests of Experts

As of March 17, 2006, KPMG LLP and its partners did not hold any registered ownership interests, directly or indirectly, in the securities of KFSI or its associates or affiliates.

15. ADDITIONAL INFORMATION

Financial information about the Corporation is contained in its comparative financial statements and Management s Discussion and Analysis for fiscal year ended December 31, 2005, and additional information relating to the Corporation is on SEDAR at www.sedar.com.

Additional information, including directors and officers remuneration and indebtedness, the principal holders of KFSI securities and securities authorized for issuance under equity compensation plans, where applicable, is contained in KFSI s Proxy Circular dated as of March 17, 2006 in connection with its Annual Meeting of Shareholders to be held on May 4, 2006, which involves the election of directors.

Copies of the Annual Information Form, as well as copies of the 2005 Annual Report of KFSI for the year ended December 31, 2005 and Proxy Circular dated March 17, 2006 may be obtained from:

Kingsway Financial Services Inc., Secretary
c/o Fogler Rubinoff LLP
95 Wellington Street West
Suite 1200,

Toronto-Dominion Centre
Toronto, Ontario M5J 2Z9
Telephone: 416-841-8857
Fax: 416-841-8852

APPENDIX I

**KINGSWAY FINANCIAL SERVICES INC.
AUDIT COMMITTEE CHARTER**

I. Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to (a) the integrity of the Company s financial statements, (b) the Company s compliance with legal and regulatory requirements, (c) the external auditor s qualifications and independence, and (d) the performance of the Company s internal audit function and the performance of the external auditors. The Audit Committee s primary duties and responsibilities are to:

> Identify and monitor the management of the principal risks that could impact the financial reporting of the Company.

> Monitor the integrity of the Company s financial reporting process and system of internal controls regarding financial reporting and accounting appropriateness and compliance.

> Monitor the independence and performance of the company s external auditors and the external appointed actuary.

> Provide an avenue of communication among the external auditors, external appointed actuary, management and the Board of Directors.

> Review the annual audited financial statements with management and the external auditors.

II. Organization

Audit Committee members shall meet the requirements of the Business Corporations Act (Ontario) and the Toronto Stock Exchange and the New York Stock Exchange. The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be outside directors who are unrelated, free from any relationship that would interfere with the exercise of his or her independent judgment. All members of the Committee shall be financially literate, being defined as able to read and understand basic financial statements, and the Chair of the Committee shall have accounting or related financial management expertise. The Audit Committee shall assist the Board in determining whether or not one or more members of the Audit Committee is an audit committee financial expert as defined in SEC Release 33-8177.

Audit Committee members shall be appointed by the Board annually at the meeting of the Board of Directors immediately following the annual meeting. The Audit Committee Chair shall be designated by the full board or if it does not do so, the members of the Committee may designate a Chair by majority vote of the Committee membership.

III. Structure and Meetings

The Committee shall meet at least quarterly, or more frequently as circumstances dictate. The Audit Committee Chair shall prepare and/or approve an agenda in advance of each meeting. The Committee should meet privately in executive session with each of management, the external auditors, the external appointed actuary, the internal auditor and as a committee to discuss any matters that the Committee or each of these groups believe should be discussed.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well any other employees or consultants to Kingsway and its subsidiaries. The Audit Committee has the ability to retain, at the Company s expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

IV. Responsibilities and Duties

The Audit Committee shall have the power and authority of the Board of Directors to perform the following duties and fulfil the following responsibilities.

Review Procedures

1. Review and reassess the adequacy of this Mandate at least annually and submit the mandate to the Board of Directors for approval.

2. Review the Company s annual audited financial statements and discuss the Company s quarterly financial statements and related documents prior to filing or distribution. Review should include discussion with management and external auditors of significant issues regarding accounting principles, practice, and significant management estimates and judgments as well as the contents of Management s Discussion and Analysis .

3. Annually, in consultation with management, external auditors, and external appointed actuary, consider the integrity of the Company s financial reporting processes and controls. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures. Review significant findings prepared by the external auditors together with management s responses.

4. Review the effectiveness of the overall process for identifying the principal risks affecting financial reporting and provide the Committee s view to the Board of Directors.

5. Review the Company s quarterly financial results and related documents prior to the release of earnings and/or the company s quarterly financial statements prior to filing or distribution shall be reviewed by the full Board of Directors.

6. Discuss the Company s earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies.

External Auditors & Actuaries

7. The external auditors are ultimately accountable to the Audit Committee and the Board of Directors, as representatives of the shareholders. The Audit Committee shall review the independence and performance of the auditors and annually recommend to the Board of Directors the appointment of the external auditors or approve any discharge of auditors when circumstances warrant.

8. Approve the appointment, compensation and work carried out by the external auditors, including the provision of both audit related and non-audit related services.

9. On not less than an annual basis, the Committee should review and discuss with the external auditors all significant relationships they have with the Company that could impair the auditors independence.

10.

Review the external auditors audit plan discuss and approve audit scope, staffing, locations, reliance upon management and general audit approach.

11. On an annual basis review with the external auditors:

    i. all critical accounting policies and practices to be used in connection with the auditor s report.

    ii. all alternative treatments within GAAP for policies and practices related to material items that have been discussed with management, including ramifications of the use of such alternative disclosures and treatments; and the treatment preferred by the auditor; and

    iii. other material written communications between the auditor and the management of the Company, such as any management representation letter, schedule of unadjusted differences, reports on observations and recommendations on internal control, engagement letter and independence letter.

12. Prior to releasing the year-end earnings, discuss the results of the audit with the external auditors. Discuss certain matters required to be communicated to audit committees in accordance with the standards established by the Canadian Institute of Chartered Accountants.

13. Consider the external auditors judgments about the quality and appropriateness of the Company s accounting principles as applied in the Company s financial reporting.

14. Set clear hiring policies for employees or former employees of the external auditors.

15. Consider the external appointed actuary s judgment about the appropriateness of management s selection of assumptions of methods to determine the unpaid claims liabilities included in the company s year-end financial statements.

Internal Audit Department and Legal Compliance

16. Discuss policies with respect to risk assessment and risk management.

17. On an annual basis, obtain and review a report by the external auditor describing the Company s internal quality-control procedures and any material issues raised by the most recent internal quality-control review, or peer review of the Company.

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

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

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

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

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

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

24. Periodically review the Company s director and officer liability insurance coverage.

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

Other Audit Committee Responsibilities

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

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

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

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

30. Review financial and accounting personnel succession planning within the company.

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

February 2004

Document No. 2

Consolidated Financial Statements of

KINGSWAY FINANCIAL SERVICES INC.

Years ended December 31, 2005 and 2004

MANAGEMENT STATEMENT ON RESPONSIBILITY FOR FINANCIAL INFORMATION

Management is responsible for presentation and preparation of the annual consolidated financial statements, Management s Discussion and Analysis (MDA) and all other information in the Company s Annual Report. The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles and also include a reconciliation to generally accepted accounting principles in the United States. Financial information appearing elsewhere in the Company s Annual Report is consistent with the consolidated financial statements.

The MDA has been prepared in accordance with the requirements of Canadian securities regulators as well as the requirements of Item 303 of Regulation S-K of the Securities Exchange Act of the United States, and their related published requirements.

The consolidated financial statements and information in the MDA necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. In addition, in preparing the financial information management must make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MDA also includes information regarding the estimated impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from management s present assessment of this information because future events and circumstances may not occur as expected.

In meeting its responsibility for the reliability of the consolidated financial statements and for the accounting systems from which they are derived, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, that assets are safeguarded against unauthorized use or disposition and that liabilities are recognized.

We, as Kingsway Financial s Chief Executive Officer and Chief Financial Officer, will certify the Kingsway Financial Services Inc. s annual filings with the Canadian Securities Administrators and the Securities and Exchange Commission as required in Canada by Multilateral Instrument 52-109 (Certification of Disclosure in Issuers Annual and Interim Filings) and in the United States by the Sarbanes-Oxley Act.

The Board of Directors oversees management s responsibilities for financial reporting through an Audit Committee, which is composed entirely of directors who are neither officers nor employees of the Company. The Audit Committee reviews the consolidated financial statements and recommends them to the board for approval. The Audit Committee also reviews and monitors the Company s system of internal controls as reported by management or the external auditors.

Role of the Actuary

With respect to the preparation of these financial statements, management prepares a valuation, including the selection of appropriate assumptions, of the Company s obligations at the balance sheet date under insurance policies issued by its subsidiaries. With respect to the preparation of these financial statements, the independent actuary, David J. Oakden of Tillinghast, a business of Towers Perrin, carries out a review of management s valuation of the unpaid claim liabilities and provides an opinion to the Board of Directors regarding the appropriateness of the unpaid claim liabilities recorded by management to meet all policyholder claim obligations of the Company at the balance sheet date. The work to form that opinion includes an examination of the sufficiency and reliability of data, and review of the valuation process used by management. The independent actuary is responsible for assessing whether the assumptions and methods used for the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the review of these liabilities determined by management, which are by their very nature inherently variable, the actuary makes assumptions as to future loss ratios, trends, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Company and the nature of the insurance policies. In carrying out their work, the independent actuary makes use of the work of the external auditors with regards to data upon which their calculations are based.

The valuation is based on projections of future claims and claim adjustment expenses on claims incurred at the balance sheet date. It is certain that actual future claims and claim adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for new classes or claim categories not sufficiently recognized in the claims database.

Management is responsible for the accuracy and completeness of the underlying data used in the valuation. The actuary s report outlines the scope of the review and the opinion.

Role of the Auditor

The external auditors, KPMG LLP, have been appointed by the shareholders. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and to report thereon to the shareholders. In carrying out their audit, the auditors make use of the work of the independent actuary and their report on the claim liabilities of the Company. The auditors work on the financial statements encompasses the claim liabilities. The shareholders auditors have full and unrestricted access to the Board of Directors and the Audit Committee to discuss audit, financial reporting and related findings. The auditors report outlines the scope of their audit and their opinion.

/s/ William G. Star

William G. Star
President & Chief Executive Officer

/s/ W. Shaun Jackson

W. Shaun Jackson
Executive Vice President & Chief Financial Officer

February 7, 2006

AUDITORS REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Kingsway Financial Services Inc. as at December 31, 2005 and December 31, 2004 and the consolidated statements of operations, retained earnings, currency translation adjustment and cash flows for each of the years in the three-year period ended December 31, 2005. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and December 31, 2004 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

/s/ KPMG LLP
Chartered Accountants

Toronto, Canada
February 7, 2006 except as to note 13(a) which is as of February 15, 2006

ACTUARY S REPORT

I have reviewed the unpaid claims liabilities of Kingsway Financial Services Inc. determined by management and recorded in its consolidated balance sheet at December 31, 2005 and their changes in the consolidated statement of operations for the year then ended in accordance with Canadian accepted actuarial practice.

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

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

The unpaid claims liabilities as at December 31, 2004 and the changes in unpaid claims for the two year yearly periods then ended were reviewed by another actuary. The other actuary s report dated February 8, 2005 expressed an opinion without reservation except that it contained a similar exception for management choosing not to reflect the time value of money in determining the valuation of the unpaid claims liabilities as referred to the above.

/s/ David J. Oakden
David J. Oakden, Towers Perrin Inc.
Fellow Canadian Institute of Actuaries

February 7, 2006

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Balance Sheets

As at December 31
(In thousands of U.S. dollars)

	2005	2004
Assets		
Cash and cash equivalents	$ 111,034	$ 87,103
Investments (note 3)	2,803,790	2,495,708
Accrued investment income	25,126	21,046
Accounts receivable and other assets	282,764	328,819
Due from reinsurers and other insurers (note 8)	222,974	260,396
Deferred policy acquisition costs	148,829	141,910
Income taxes recoverable	--	10,428
Future income taxes (note 9)	57,939	48,146
Capital assets (note 4)	71,608	58,516
Goodwill and intangible assets (notes 2(f) & 11(b))	71,130	67,320
	$3,795,194	$3,519,392
Liabilities and Shareholders Equity		
Liabilities:		
Bank indebtedness (note 13(a))	$ 11,767	$ 59,902
Loans payable (note 13(d))	66,222	--
Accounts payable and accrued liabilities	129,666	110,345
Income taxes payable	6,817	--
Funds withheld payable to reinsurer	--	78,691
Unearned premiums	649,228	634,336
Unpaid claims (note 10)	1,844,211	1,689,225
Senior unsecured debentures (note 13(b))	192,068	189,892
Subordinated indebtedness (note 13(c))	90,500	90,500
	2,990,479	2,852,891
Shareholders equity:		
Share capital (note 5)	331,470	328,544
Contributed surplus	3,237	1,769
Currency translation adjustment	9,958	1,720
Retained earnings	460,050	334,468
	804,715	666,501
Contingent liabilities (note 15)		
	$3,795,194	$3,519,392

See accompanying notes to consolidated financial statements.

On behalf of the Board:

/s/ F. Michael Walsh
Director

/s/ David H. Atkins
Director

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Operations

Years ended December 31
(In thousands of U.S. dollars, except per share amounts)

	2005	2004	2003
Gross premiums written	$ 1,894,660	$ 2,001,806	$ 1,887,214
Net premiums written	$ 1,824,393	$ 1,739,264	$ 1,802,978
Revenue:			
Net premiums earned (note 8)	$ 1,791,943	$ 1,778,374	$ 1,711,910
Net investment income (note 3)	93,035	74,266	56,226
Net realized gains (note 3)	38,239	20,392	41,466
	1,923,217	1,873,032	1,809,602
Expenses:			
Claims incurred (notes 8 and 10)	1,224,506	1,260,093	1,275,128
Commissions and premium taxes (note 8)	361,875	330,769	361,370
General and administrative expenses	155,773	148,096	102,640
Interest expense	25,921	21,171	15,106
Amortization of intangible assets	795	530	611
	1,768,870	1,760,659	1,754,855
Income before income taxes	154,347	112,373	54,747
Income taxes(recovery) (note 9):			
Current	28,208	4,004	7,371
Future	(8,869)	7,355	(13,501)
	19,339	11,359	(6,130)
Net income	$ 135,008	$ 101,014	$ 60,877
Earnings per share (note 5):			
Basic	$2.39	$1.80	$1.16
Diluted	$2.37	$1.79	$1.15
Dividends declared per common share	C$0.20	C$ --	C$ --

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Retained Earnings

Years ended December 31
(In thousands of U.S. dollars)

	2005	2004	2003
Retained earnings, beginning of year	$334,468	$233,454	$172,577
Net income	135,008	101,014	60,877
Common share dividends	(9,426)	--	--
Retained earnings, end of year	$460,050	$334,468	$233,454

See accompanying notes to consolidated financial statements.

Consolidated Statements of Currency Translation Adjustment

Years ended December 31
(In thousands of U.S. dollars)

	2005	2004	2003
Currency translation adjustment, beginning of year	$1,720	$(6,747)	$(24,683)
Net unrealized foreign exchange translation gains	8,238	8,467	17,936
Currency translation adjustment, end of year	$9,958	$ 1,720	$ (6,747)

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows

Years ended December 31
(In thousands of U.S. dollars)

	2005	2004	2003
Cash provided by (used in):			
Operating activities:			
Net income	$ 135,008	$ 101,014	$ 60,877
Items not affecting cash:			
Amortization of intangibles	795	530	611
Amortization of capital assets and deferred charges	6,884	7,422	6,702
Future income taxes	(6,924)	7,115	(19,369)
Net realized gains	(38,239)	(20,392)	(41,466)
Amortization of bond premiums and discounts	10,825	19,777	10,780
	108,349	115,466	18,135
Change in non-cash balances:			
Deferred policy acquisition costs	(2,868)	(12,339)	(30,616)
Due from reinsurers and other insurers	34,713	(212,948)	(96,048)
Increase (decrease) in funds withheld payable to reinsurer	(78,691)	78,691	--
Unearned premiums	(10,386)	27,744	94,769
Unpaid claims	149,891	381,642	544,238
Increase in contributed surplus	1,468	1,242	527
Net change in other non-cash balances	71,271	12,162	(59,707)
	273,747	391,660	471,298
Financing activities:			
Increase of share capital, net	2,926	2,434	83,109
Common share dividend	(9,426)	--	--
Increase (decrease) in bank indebtedness and loans payable	17,378	(63,044)	9,708
Increase in senior unsecured debentures	--	125,000	--
Increase in subordinated indebtedness	--	--	75,500
	10,878	64,390	168,317
Investing activities:			
Purchase of investments	(2,590,018)	(2,408,406)	(4,669,561)
Proceeds from sale of investments	2,356,581	1,959,283	4,010,527
Financed premiums receivable, net	3,973	(17,617)	192
Purchase of subsidiaries, net of cash acquired (note 11)	(11,892)	--	--
Additions to capital assets	(19,338)	(12,790)	(26,390)
	(260,694)	(479,530)	(685,232)
Increase (decrease) in cash during the year	23,931	(23,480)	(45,617)
Cash and cash equivalents, beginning of year	87,103	110,583	156,200
Cash and cash equivalents, end of year	$ 111,034	$ 87,103	$ 110,583

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows

Years ended December 31
(In thousands of U.S. dollars)

	2005	2004	2003
Supplementary disclosure of cash information:			
Represented by:			
Cash on hand and balances with banks	$100,290	$85,879	$110,583
Investments with maturities less than 30 days	10,744	1,224	--
Cash and cash equivalents, end of year	$111,034	$87,103	$110,583
Cash paid for:			
Interest	$ 25,474	$18,753	$ 14,326
Income taxes	13,141	14,995	6,141

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

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

1. Change in Reporting Currency:

As the majority of the Company s operations is in the United States and conducts their business in U.S. dollars, effective December 31, 2005, the Company has reported its consolidated financial statements in U.S. dollars in order to provide more meaningful information to its financial statement users. Prior to this date the Company reported its consolidated results in Canadian dollars. The Company s functional currency will remain Canadian dollars for Canadian and head office operations and U.S. dollars for U.S. operations. Any reported Canadian dollar amounts will be identified with a C$.

To effect this conversion, the consolidated financial statements have been translated into U.S. dollars using the current rate method, pursuant to which the consolidated statements of earnings and cash flows have been translated using the average rate of exchange for the relevant year. All assets and liabilities have been translated using the relevant year end rate of exchange and share capital amounts have been translated using the rates of exchange in effect as of the dates of various capital transactions. All relevant financial information has been restated to reflect the Company s results as if they had been historically reported in U.S. dollars. Foreign exchange differences arising from the translation as described above have been recorded in the currency translation account which is included as a separate component of shareholders equity.

2. Summary of significant accounting policies:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition, and divestitures are included up to the date of disposal. Assets and liabilities of the acquired companies are included in the financial statements at their fair values at the date of acquisition. The Company holds interests in variable interest entities that are not included in the consolidated financial statements which are more fully described in note 14.

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2. Summary of significant accounting policies (continued):

(a) Principles of consolidation (continued):

The following is a list of our material subsidiaries, all of which are 100% owned, directly or indirectly, (except for qualifying shares of York Fire & Casualty Insurance Company and Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements), with the jurisdiction of incorporation indicated in brackets:

American Country Holdings Inc. (Illinois); American Country Insurance Company (Illinois); American Country Financial Services Corp. (Illinois); American Country Underwriting Agency Inc. (Illinois); American Country Professional Services Corp. (Illinois); American Service Investment Corporation (Illinois); American Service Insurance Company, Inc. (Illinois); ARK Insurance Agency Inc. (Illinois); Avalon Risk Management, Inc. (Illinois); Appco Finance Corporation (Florida); AOA Payment Plan Inc. (Illinois); Auto Body Tech Inc. (Florida); Funding Plus of America (Alabama); Hamilton Risk Management Company (Florida); HI Holdings, Inc. (Hawaii); Insurance Management Services Inc. (Florida); U.S. Security Insurance Company (Florida); Jevco Insurance Company (Canada); Kingsway America Inc. (Delaware); Kingsway Nova Scotia Finance, ULC (Nova Scotia); Kingsway General Insurance Company (Ontario); Kingsway Reinsurance (Bermuda) Ltd. (Bermuda); Kingsway Reinsurance Corporation (Barbados); Kingsway U.S. Finance Partnership (Delaware); Kingsway U.S. Tier II Finance Partnership (Delaware); Southern United Holding, Inc. (Alabama); Southern United Fire Insurance Company (Alabama); Southern United General Agency of Texas, Inc. (Texas); UCC Corporation (Nevada); Universal Casualty Company (Illinois); Walshire Assurance Company (Pennsylvania); Lincoln General Insurance Company (Pennsylvania); York Fire & Casualty Insurance Company (Ontario); and Zephyr Insurance Company (Hawaii).

(b) Use of estimates:

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

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

2. Summary of significant accounting policies (continued):

(c) Investments:

Fixed term investments are carried at amortized cost providing for the amortization of the discount or premium on a constant yield basis to maturity. Investments in common and preferred shares are carried at cost. Where a decline in value of an investment is considered to be other than temporary a write-down of the investment is recorded.

(d) Investment income:

Investment income is recorded as it accrues. Dividend income on common and preferred shares is recorded on the ex-dividend date. Gains and losses on disposal of investments are determined and recorded as at the trade date, and are calculated on the basis of average cost.

(e) Cash and cash equivalents:

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

(f) Goodwill and other intangible assets:

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

Goodwill is tested at least annually for impairment to ensure that its fair value is greater than or equal to the carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. At December 31, 2005 and 2004, the carrying value of goodwill was $68,880,000 and $64,275,000, respectively (note 11(b)).

When the Company acquires a subsidiary or other business where it exerts significant influence, certain intangible assets may be acquired, which are recorded at their fair value at the time of the acquisition. Intangible assets with a definite useful life are amortized to income on a straight line basis over its defined useful life. The Company writes down the value of an intangible asset with a definite useful life when the undiscounted cash flows are not expected to allow for full recovery of the carrying value. At December 31, 2005 and 2004 intangible assets with a definite useful life, net of accumulated amortization, were $nil and $795,000, respectively.

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

2. Summary of significant accounting policies (continued):

(f) Goodwill and other intangible assets (continued):

Intangible assets with an indefinite useful life are not subject to amortization and are tested at least annually for impairment to ensure that its fair value is greater than or equal to its carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. At December 31, 2005 and 2004 the Company had intangible assets with an indefinite life of $2,250,000 and $2,250,000, respectively.

Amortization of intangible assets reported in the Consolidated Statements of Operations for the years ended December 31, 2005, 2004 and 2003 was $795,000, $530,000 and $611,000, respectively. There were no write-downs of goodwill or intangible assets due to impairment during the years ended December 31, 2005, 2004, and 2003.

(g) Deferred policy acquisition costs:

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

(h) Premium revenue and unearned premiums:

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

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

2. Summary of significant accounting policies (continued):

(h) Premium revenue and unearned premiums (continued):

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

(i) Unpaid claims:

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

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

(j) Reinsurance:

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

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

2. Summary of significant accounting policies (continued):

(j) Translation of foreign currencies:

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

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

(k) Income taxes:

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

(m) Stock-based compensation plan:

The Company has a stock-based compensation plan which is described in note 6. The Company uses the fair-value method of accounting for stock-based compensation awards granted to employees and non-employee directors for options granted on or after January 1, 2003. The Company determines the fair value of the stock options on their grant date using the Black-Scholes option pricing model and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the amount of proceeds, together with the amount recorded in contributed surplus, is recorded in share capital.

2. Summary of significant accounting policies (continued):

(m) Stock-based compensation plan (continued):

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

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

(n) Capital assets:

Capital assets are reported in the financial statements at amortized cost. Amortization of property and equipment has been provided by the straight-line method over the estimated useful lives of such assets. The useful lives range from 10 to 40 years for buildings, 3 to 39 years for leasehold improvements, 3 to 7 years for furniture and equipment, 3 to 5 years for computers and software development, and 3 to 5 years for automobiles.

3. Investments:

The carrying amounts and fair values of investments are summarized below:

		December 31, 2005			
		Carrying amount	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
Term deposits		$ 383,071	$ 10	$ 1,347	$ 381,734
Bonds:					
Canadian	Government	199,500	3,432	276	202,656
	Corporate	279,953	6,558	756	285,755
U.S.	Government	144,835	374	2,092	143,117
	Corporate	1,122,624	1,831	24,425	1,100,030
Other	Government	83,981	43	1,996	82,028
	Corporate	179,002	89	3,433	175,658
Sub-total		$2,392,966	$12,337	$34,325	$2,370,978
Preferred shares	Canadian	1,290	62	--	1,352
Common shares	Canadian	152,347	32,522	6,127	178,742
	U.S.	171,483	19,087	5,357	185,213
Financed premiums		85,704	--	--	85,704
		$2,803,790	$64,008	$45,809	$2,821,989

3. Investments (continued):

The maturity profile of the bonds and term deposits investments at their carrying amounts and fair values as at December 31, 2005 is as follows:

	Carrying Amount	Fair Value
Due in one year or less	$ 717,729	$ 712,709
Due after one year through five years	1,075,914	1,057,350
Due after five years through ten years	465,112	467,484
Due after ten years	134,211	133,435
	$2,392,966	$2,370,978

		December 31, 2004			
		Carrying Amount	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Term deposits		$ 264,437	$ 57	$ 245	$ 264,249
Bonds:					
Canadian	Government	187,953	4,563	42	192,474
	Corporate	244,947	7,483	255	252,175
U.S	Government	177,462	666	2,166	175,962
	Corporate	964,091	5,649	7,762	961,978
Other	Government	125,475	151	975	124,651
	Corporate	174,309	--	2,067	172,242
Sub-total		$2,138,674	$18,569	$13,512	$2,143,731
Common shares	Canadian	154,268	37,017	1,265	190,020
	U.S.	115,551	21,880	1,359	136,072
Financed premiums		87,215	--	--	87,215
		$2,495,708	$77,466	$16,136	$2,557,038

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

3. Investments (continued):

The maturity profile of the bonds and term deposits investments at their carrying amounts and fair values as at December 31, 2004 is as follows:

	Carrying Amount	Fair Value
Due in one year or less	$ 480,549	$ 479,333
Due after one year through five years	1,237,454	1,237,284
Due after five years through ten years	287,950	293,737
Due after ten years	132,721	133,377
	$2,138,674	$2,143,731

The amounts are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers have the right to call or repay certain obligations with or without call or prepayment penalties.

The following tables highlight the aggregate unrealized loss position, by security type, of holdings in an unrealized loss position as at December 31, 2005 and 2004. The tables segregate the holdings based on the period of time the securities have been continuously held in an unrealized loss position.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

3. Investments (continued):

				December 31, 2005
	0-6 months	6-12 months	over 12 months	Total
Common Shares				
Number of Positions	99	5	1	105
Fair Value	$ 78,026	$ 11,617	$ 347	$ 89,990
Carrying Value	86,674	14,332	468	101,474
Unrealized Loss	(8,648)	(2,715)	(121)	(11,484)
Term Deposits and Bonds				
Number of Positions	526	49	18	593
Fair Value	$ 998,187	$ 111,911	$ 631,370	$ 1,741,468
Carrying Value	1,014,577	114,085	647,131	1,775,793
Unrealized Loss	(16,390)	(2,174)	(15,761)	(34,325)
Total				
Number of Positions	625	54	19	698
Fair Value	$ 1,076,213	$ 123,528	$ 631,717	$ 1,831,458
Carrying Value	1,101,251	128,417	647,599	1,877,267
Unrealized Loss	(25,038)	(4,889)	(15,882)	(45,809)

	December 31, 2004			
	0-6 months	6-12 months	over 12 months	Total
Common Shares				
Number of Positions	45	6	1	52
Fair Value	$ 29,010	$ 3,164	$ 190	$ 32,364
Carrying Value	31,178	3,618	192	34,988
Unrealized Loss	(2,168)	(454)	(2)	(2,624)
Term Deposits and Bonds				
Number of Positions	248	72	21	341
Fair Value	$ 662,566	$ 446,031	$ 170,307	$ 1,278,904
Carrying Value	666,762	451,467	174,187	1,292,416
Unrealized Loss	(4,196)	(5,436)	(3,880)	(13,512)
Total				
Number of Positions	293	78	22	393
Fair Value	$ 691,576	$ 449,195	$ 170,497	$ 1,311,268
Carrying Value	697,940	455,085	174,379	1,327,404
Unrealized Loss	(6,364)	(5,890)	(3,882)	(16,136)

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

3. Investments (continued):

Fair values of term deposits, bonds and common and preferred shares are measured using approximate quoted market values based on the latest bid prices. Financed premiums represent the portion of the insured s monthly premium payments that are not yet due. Certain insureds have the option to pay a portion of the premium when the policy is placed in force and the balance in monthly instalments. The insured pays an additional premium for this option, reflecting handling costs and the investment income that would have been earned on such premium, had the total amount been collected at the beginning of the policy period. The additional premium is essentially an interest payment on the balance of the unpaid premium and is recognized as investment income over the period of the policy. The fair value of financed premiums, which are realized over the term of the related policies of up to one year, approximates their carrying amount.

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

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

identifying all security holdings in an unrealized loss position that has existed for at least six months;

obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;

reviewing the trading range of certain securities over the preceding calendar period;

assessing if declines in market value are other than temporary for debt security holdings based on the investment grade credit rating from third party security rating agencies;

3. Investments (continued):

assessing if declines in market value are other than temporary for any debt security holding with non-investment grade credit rating based on the continuity of their debt service record; and

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

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

the opinion of professional investment managers could be incorrect;

the past trading patterns of individual securities may not reflect future valuation trends;

the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a company s financial situation; and

the debt service pattern of non-investment grade securities may not reflect future debt service capabilities and may not reflect the company s unknown underlying financial problems.

The length of time securities may be held in an unrealized loss position may vary based on the opinion of the appointed investment managers and their respective analyses related to valuation and the various credit risks that may prevent the Company from recapturing the principal investment. If the appointed investment manager determines there is little or no risk of default prior to the maturity of a holding, the Company would elect to hold the security in an unrealized loss position until the price recovers or the security matures.

In situations where facts emerge that might increase the risk associated with recapture of principal, securities would be traded and losses realized. Due to the current volatility of the equity markets, the Company believes there are a number of securities currently trading at values below their respective intrinsic values based on historical valuation measures. In these situations, holdings may be maintained in an unrealized loss position for different periods of time based on the underlying economic assumptions influencing the investment manager s valuation of the holding. In cases where the economic realities divert from the underlying assumptions driving the investment manager s valuation, securities would be traded and losses realized. In cases where the economic assumptions coincide with valuation assumptions, the holding would be maintained until the market value of the security recovers in the public markets.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

3. Investments (continued):

All of the Company s fixed term investments have fixed interest rates. The coupon rates for the Company s fixed term investments range from 1.50% to 12.00% at December 31, 2005 and 1.50% to 15.00% at December 31, 2004.

The Company limits its investment concentration in any one investee or related group of investees other than government issues, to less than 5% of the Company s investments.

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

	2005	2004	2003
Investment income:			
Interest on short-term investments	$ 9,881	$ 6,335	$ 5,516
Interest on bonds	73,615	56,114	38,269
Dividends	8,939	5,707	3,619
Premium finance	7,059	8,614	8,414
Other	1,447	2,309	3,169
Gross investment income	100,941	79,079	58,987
Investment expenses	7,906	4,813	2,761
Net investment income	$ 93,035	$74,266	$56,226

Net realized gains for the years ended December 31, 2005, 2004, and 2003 were $38,239,000, $20,392,000 and $41,466,000, respectively. Included in net realized gains were adjustments to the carrying value of investments for declines in market value considered other than temporary of $4,806,000, $1,291,000 and $2,495,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

As at December 31, 2005, bonds and term deposits with an estimated fair value of $34,392,000 (2004 $29,925,000) were on deposit with regulatory authorities.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

4. Capital assets:

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

	Cost	Accumulated Amortization	2005 Carrying Value
Land	$ 7,830	$ --	$ 7,830
Buildings	43,786	4,771	39,015
Leasehold Improvements	13,686	2,264	11,422
Furniture and equipment	10,407	6,389	4,018
Computers and software development	28,240	19,642	8,598
Automobiles	1,674	949	725
Total	$105,623	$34,015	$71,608

	Cost	Accumulated Amortization	2004 Carrying Value
Land	$ 6,563	$ --	$ 6,563
Buildings	36,678	3,517	33,161
Leasehold Improvements	8,026	1,070	6,956
Furniture and equipment	9,572	5,230	4,342
Computers and software development	24,024	17,081	6,943
Automobiles	1,252	701	551
Total	$86,115	$27,599	$58,516

5. Share capital:

Authorized:
Unlimited number of common shares

Share transactions consist of the following:

	Shares Issued	Stock Options	Weighted-Average Exercise Price*	Amount
Balance as at December 31, 2002	48,794,212	1,712,220	$11.17	$243,002
Issued July 3, 2003	6,100,000			74,175

Issued July 11, 2003	610,000			7,210
Stock options:				
Granted in year		525,000	13.53	
Exercised in year	325,582	(325,582)	7.40	1,724
Forfeited in year		(19,503)	11.88	
Expired in year		(206,000)	14.75	
Balance as at December 31, 2003	55,829,794	1,686,135	$12.19	$326,111
Stock options:				
Granted in year		481,000	15.19	
Exercised in year	380,456	(380,456)	8.46	2,433
Forfeited in year		(55,167)	15.69	
Expired in year			11.50	
Balance as at December 31, 2004	56,210,250	1,731,510	$13.73	$328,544
Stock options:				
Granted in year		552,576	19.70	
Exercised in year	270,203	(270,203)	11.48	2,511
Forfeited in year		(46,368)	17.91	
Expired in year		--	--	
Stock-based compensation expense				415
Balance as at December 31, 2005	56,480,453	1,967,515	$15.66	$331,470

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

KINGSWAY FINANCIAL SERVICES INC.

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

5. Share capital (continued):

Share issue expenses of $2,232,000 net of applicable income taxes of $1,265,000 were deducted from the amount of share capital issued on July 3, 2003 and July 11, 2003.

(a) During the year ended December 31, 2005, options to acquire 270,203 shares (2004 380,456; 2003 325,582 shares) were exercised at prices from C$4.30 to C$19.66 per share (2004 C$4.30 to C$15.19 per share; 2003 C$4.30 to C$11.50 per share).

(b) The weighted average number of shares outstanding for the years ended December 31, 2005, 2004 and 2003 were 56,423,207, 56,123,976 and 52,306,647, respectively. On a diluted basis, the weighted average number of shares outstanding for the years ended December 31, 2005, 2004 and 2003 were 56,962,868, 56,549,496 and 52,770,878, respectively.

(c) During 2005, the Company declared dividends of C$0.05 per share payable quarterly in Canadian dollars. Total dividends declared in 2005 were C$0.20 per common share. During 2005 a total of C$11,291,300 was paid in dividends to common shareholders.

(d) Options exercised during the year resulted in a $415,000 increase in share capital from contributed surplus.

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

6. Stock-based compensation:

(a) The Company has established a stock option incentive plan for directors, officers and key employees of the Company and its subsidiaries. At December 31, 2005, the maximum number of common shares that may be issued under the plan is 4,800,000 (2004 4,800,000) common shares. The maximum number of common shares available for issuance to any one person under the stock option plan is 5% of the common shares outstanding at the time of the grant. The exercise price is based on the market value of the shares at the time the option is granted. In general, the options vest evenly over a three year period and are exercisable for periods not exceeding 10 years.

The following tables summarize information about stock options outstanding as at December 31, 2005, December 31, 2004 and December 31, 2003:

6. Stock-based compensation (continued):

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

December 31, 2005

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

December 31, 2004

Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable

C$15.19	12-Feb-04	12-Feb-09	4.1	453,833	--
C$13.53	10-Feb-03	10-Feb-13	8.1	485,169	182,836
C$19.66	21-Feb-02	21-Feb-12	7.2	403,500	269,000
C$ 7.80	22-Feb-01	22-Feb-11	6.2	202,339	202,339
C$ 4.30	24-Feb-00	24-Feb-10	5.2	186,669	186,669
Total			6.3	1,731,510	840,844

December 31, 2003

Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$13.53	10-Feb-03	10-Feb-13	9.2	521,500	--
C$19.66	21-Feb-02	21-Feb-12	8.2	416,500	138,833
C$ 7.80	22-Feb-01	22-Feb-11	7.2	235,177	140,177
C$ 4.30	24-Feb-00	24-Feb-10	6.2	337,256	337,256
C$11.50	25-Feb-99	25-Feb-04	0.2	175,702	175,702
Total			7.1	1,686,135	791,968

6. Stock-based compensation (continued):

At December 31, 2005, 2004 and 2003 the number of options exercisable is 985,515, 840,844 and 791,968, respectively, with weighted average prices of C$13.89, C$12.06 and C$9.21, respectively.

The Company determines the fair value of options granted using the Black-Scholes option pricing model. The per share fair value of options granted during 2005, 2004 and 2003 was C$3.58, C$3.79 and C$6.11. The Company does not record any compensation expense for stock options granted prior to 2003. When these stock options are exercised, the Company will include the amount of proceeds in share capital. The impact on net income and earnings per share if the Company had measured the compensation element of stock options granted based on the fair value on the date of grant on all outstanding stock options on their grant date is disclosed as follows:

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

	2005	2004	2003
Stock option expense included in employee compensation expense	$ 1,883	$ 1,242	$ 527
Net income, as reported	$135,008	$101,014	$60,877
Additional expense that would have been recorded if all outstanding stock options granted before January 1, 2003 had been expensed	68	1,452	1,165
Pro forma net income	$134,940	$ 99,562	$59,712
Basic earnings per share			
As reported	$2.39	$1.80	$1.16
Pro forma	2.39	1.77	1.14
Diluted earnings per share			
As reported	$2.37	$1.79	$1.15
Pro forma	2.37	1.76	1.13

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

6. Stock-based compensation (continued):

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

	2005	2004	2003
Risk-free interest rate	3.53%	3.49%	5.07%
Dividend yield	0.9%	0.0%	0.0%
Volatility of the expected market price of the Company s common shares	22.5%	30.3%	43.5%
Expected option life (in years)	3.9	4.7	5.5

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

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

(b) The Company has an employee share purchase plan where qualifying employees can choose each year to have up to 5% of their annual base earnings withheld to purchase the Company s common shares. The Company matches one half of the employee contribution amount, and its contributions vest immediately. All contributions are used by the plan administrator to purchase common shares in the open market. The Company s contribution is expensed as paid and for the years ended December 31, 2005, 2004 and 2003 totalled $553,000, $390,000 and $276,000, respectively.

7. Pension Benefits:

The Company maintains a separate defined contribution pension plan in Canada and in the U.S. for all of its qualified employees including the employees of all subsidiaries. In Canada, qualifying employees can choose each year to have up to 5% of their annual base earnings withheld to contribute to the applicable plan. The Company matches one half of the employee contribution amount, and its contributions vest immediately. In the U.S., qualifying employees can choose to voluntarily contribute up to 60% of their annual earnings to an overall limitation of $14,000 in 2005, $13,000 in 2004 and $12,000 in 2003. The Company matches one half of the employee contribution amount up to 5% of their annual base earnings. The contributions

7. Pension Benefits (continued):

for the U.S. plan vest based on years of service with 100% vesting after five years of service. The Company s contribution is expensed as paid and for the years ended December 31, 2005, 2004 and 2003 totalled $1,247,000, $1,058,000 and $858,000, respectively. All Company obligations to the plans were fully funded as of December 31, 2005.

Prior to December 31, 1997, substantially all salaried employees of the Company s subsidiary American Country were covered by a defined benefit pension plan sponsored by American Country. Effective December 31, 1997, upon resolution of its board of directors, the plan was frozen. The reported pension expense for American Country was $113,000, $60,000 and $76,000 in 2005, 2004, and 2003 respectively.

8. Underwriting policy and reinsurance ceded:

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

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

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

	Years ended December 31		
	2005	2004	2003

Property claims			
Canadian operations	C$500	C$500	C$500
U.S. operations	$500	$500	$500
Casualty claims			
Canadian operations	C$2,500	C$2,500	C$2,500
U.S. operations	$1,000	$1,000	$1,000

8. Underwriting policy and reinsurance ceded (continued):

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

	Years ended December 31		
	2005	2004	2003
Canada			
Retained loss	C$5,000	C$5,000	C$5,000
Maximum coverage	C$145,000	C$145,000	C$145,000
United States			
Retained loss	$2,000	$2,000	$5,000
Maximum coverage	$18,000	$18,000	$45,000

On October 31, 2005, the Company acquired Zephyr Insurance Inc. (Zephyr) in Hawaii. Zephyr is protected by a separate catastrophe reinsurance program under a 95% quota-share treaty and excess of loss treaty. Under this program Zephyr retains up to $7,300,000 in net losses subject to a maximum cover of $911,000,000.

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

The unearned premium balance is affected by the reinsurance ceded as a portion of the unearned premium will be owed to the reinsurer as the premiums are earned in the subsequent periods. The amounts deducted for reinsurance ceded from net premiums earned, claims incurred and commissions and premium taxes for the years December 31, 2005, 2004 and 2003 were as follows:

	2005	2004	2003
Net premiums earned	$123,715	$213,135	$91,414
Claims incurred	90,506	152,187	68,017
Commissions and premium taxes	34,498	54,435	17,375

The amount of assumed premiums written was $141,799,000, $232,431,000 and $239,294,000 for the years ended December 31, 2005, 2004 and 2003, respectively. The amount of assumed premiums earned was $142,831,000, $235,054,000 and $122,584,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

9. Income taxes:

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

	2005	2004	2003
Provision for taxes at Canadian statutory marginal income tax rate	$ 55,750	$ 40,589	$ 20,048
Non-taxable investment income	(1,812)	(1,117)	(590)
Foreign operations subject to different tax rates	(34,218)	(28,493)	(23,415)
Change in tax rates and other	(381)	380	(2,173)
Provision for (recovery of) income taxes	$ 19,339	$ 11,359	$ (6,130)

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

	2005	2004
Future income tax assets:		
Losses carried forward	$10,924	$10,741
Unpaid claims and unearned premiums	30,037	29,055
Investments	10,276	8,811
Share issue expenses	1,298	2,259
Contingent commission accruals	12,358	3,937
Other	5,565	3,412
Valuation allowance	(500)	(500)
Future income tax assets	69,958	57,715
Future income tax liabilities:		
Deferred policy acquisition costs	(7,943)	(6,780)
Investments	(791)	(417)
Guaranteed payments	(2,238)	(2,141)
Other	(1,047)	(231)
Future income tax liabilities	(12,019)	(9,569)

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

Net future income tax assets	$57,939	$48,146

9. Income taxes (continued):

(c) Amounts and expiration dates of the operating loss carryforwards are as follows:

Year of net operating loss	Expiration date	Net operating loss
U.S. operations:		
1995	2010	$ 557
1997	2012	1,284
1999	2019	1,225
2000	2020	1,403
2001	2021	14,936
2002	2022	4,317
2003	2023	985
2004	2024	7,422

(d) The Company established valuation allowances of $500,000 and $500,000 for its gross future tax assets at December 31, 2005 and 2004, respectively. Based on the Company s expectations of adjusted taxable income, its ability to change its investment strategy, as well as reversing gross future tax liabilities, management believes it is more likely than not that the Company will fully realize the gross future tax assets, with the exception of its net operating losses. The valuation allowance at December 31, 2005 is a result of the potential inability to utilize net operating losses before expiration.

10. Unpaid claims:

(a) Nature of unpaid claims:

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

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

10. Unpaid claims (continued):

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

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

(b) Provision for unpaid claims:

The Company s annual evaluation of the adequacy of unpaid claims includes a re-estimation of the liability for unpaid claims relating to each preceding financial year compared to the liability that was originally established. The results of this comparison and the changes in the provision for unpaid claims, net of amounts recoverable from reinsurers, for the years ended December 31, 2005, 2004 and 2003 were as follows:

10. Unpaid claims (continued):

	2005	2004	2003
Unpaid claims beginning of year net	$1,463,280	$1,188,610	$ 679,738
Provision for claims occurring:			
In the current year	1,217,952	1,220,604	1,125,678
In prior years	24,233	53,196	138,482
Claims paid during the year relating to:			
The current year	(424,997)	(446,230)	(453,765)
The prior years	(674,373)	(582,869)	(355,503)
Claims transferred on expiry of quota share agreement	33,788	--	--
Currency translation adjustment	22,668	29,969	53,980
Unpaid claims end of year net	1,662,551	1,463,280	1,188,610
Reinsurers and other insurers share of unpaid claims	181,660	225,945	122,013
Unpaid claims end of year	$1,844,211	$1,689,225	$1,310,623

The results for the years ended December 31, 2005, 2004 and 2003 were adversely affected by the evaluation of unpaid claims related to prior years. In 2003, adverse development on unpaid claims came from Ontario and Alberta automobile claims and non-standard automobile claims in the southeastern United States. In 2004, adverse development on unpaid claims came primarily from Alberta non-standard automobile claims and long-haul trucking claims in the U.S. from terminated programs. In 2005, adverse development came primarily from a terminated trucking program and Alberta non-standard automobile claims.

Ontario Automobile

Ontario private passenger automobile business contributed $10.5 million of favourable development on the prior years claims in 2005 compared to adverse development of $4.8 million in 2004 and $23.1 million in 2003.

10. Unpaid claims (continued):

Alberta Automobile

Alberta non-standard automobile business contributed $12.6 million of the prior years claims development in 2005, compared to $15.7 million in 2004 and $24.3 million in 2003.

Southeastern United States Non-Standard Automobile

Southeastern United States private passenger automobile business contributed $5.1 million of favourable development on the prior years claims in 2005, compared to adverse development of $2.3 million in 2004 and $15.7 million in 2003.

Canadian and U.S. Operations Trucking

Trucking business contributed $34.2 million of the prior years claims development in 2005, compared to $30.7 million in 2004 and $22.9 million in 2003.

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

11. Acquisitions:

(a) Hamilton:

In 1999 the Company acquired all of the outstanding shares of Hamilton Investments, Inc. (Hamilton). All consideration was payable in cash, part of which was paid at closing, with the remaining payments based on the earnings of Hamilton for the fiscal years 1999 to 2003. The present value of the guaranteed future payments was accrued at the date of acquisition. The additional consideration paid during the years ended December 31, 2004, 2003 and 2002 was $2,013,750, $2,163,000 and $2,369,000, respectively. No contingent consideration based on earnings was paid.

(b) Zephyr:

On October 31, 2005, the Company acquired 100% of the voting shares of HI Holdings Inc. for $25,000,000. The transaction includes HI s wholly owned subsidiary, Zephyr Insurance Company Inc. whose primary business is residential hurricane insurance. The earnings of HI Holdings have been included in the statement of operations from November 1, 2005.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

11. Acquisitions (continued):

(b) Zephyr (continued):

HI Holdings, at the time of acquisition had total assets of approximately $71,113,000 (excluding goodwill) consisting primarily of marketable securities and total liabilities of approximately $51,541,000.

The Company has recorded preliminary goodwill of $4,326,000 relating to the acquisition. As the final purchase price has not yet been determined, as the Company is evaluating certain intangible assets, the allocation of the purchase price is subject to refinement.

12. Segmented information:

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

The segmented information for December 31, 2005 is summarized as follows:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$ 609,934	$1,284,726	$ --	$1,894,660
Net premiums earned	582,491	1,209,452	--	1,791,943
Investment income (loss)	40,595	54,129	(1,689)	93,035
Net realized gains (losses)	23,864	14,406	(31)	38,239
Interest expense	--	19,329	6,592	25,921
Amortization of capital assets	1,007	4,113	1,058	6,178
Amortization of intangible assets	--	795	--	795
Net income tax expense (recovery)	22,389	(5,805)	2,755	19,339
Net income (loss)	65,579	81,553	(12,124)	135,008
Goodwill and intangible assets	$ 7,903	$ 63,227	$ --	$ 71,130
Total assets	1,392,469	2,374,081	28,644	3,795,194

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

12. Segmented information (continued):

The segmented information for December 31, 2004 is summarized as follows:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$ 583,515	$1,418,291	$ --	$2,001,806
Net premiums earned	501,914	1,276,460	--	1,778,374
Investment income (loss)	31,694	42,984	(412)	74,266
Net realized gains	6,629	13,750	13	20,392
Interest expense	--	15,166	6,005	21,171
Amortization of capital assets	783	5,140	924	6,847
Amortization of intangible assets	--	530	--	530
Net income tax expense (recovery)	11,335	(2,920)	2,944	11,359
Net income (loss)	32,770	73,769	(5,525)	101,014
Goodwill and intangible assets	$ 7,647	$ 59,673	$ --	$ 67,320
Total assets	1,240,329	2,250,479	28,584	3,519,392

The segmented information for December 31, 2003 is summarized below:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$472,908	$1,414,306	$ --	$1,887,214
Net premiums earned	399,950	1,311,960	--	1,711,910
Investment income (loss)	24,048	32,796	(618)	56,226
Net realized gains (losses)	9,589	31,897	(20)	41,466
Interest expense	--	9,441	5,665	15,106
Amortization of capital assets	552	3,853	959	5,364
Amortization of intangible assets	--	611	--	611
Net income tax expense (recovery)	(5,794)	7,111	(7,447)	(6,130)
Net income (loss)	(12,868)	69,013	4,732	60,877
Goodwill and intangible assets	$ 7,215	$ 60,164	$ --	$ 67,379
Total assets	906,316	1,896,363	46,958	2,849,637

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

12. Segmented information (continued):

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

	2005	2004	2003
Business Line			
Personal Lines:			
Non-Standard Auto	29%	35%	37%
Standard Auto	7%	6%	4%
Motorcycle	3%	2%	2%
Property (including Liability)	3%	2%	1%
Other Specialty Lines	2%	2%	2%
Total Personal Lines	44%	47%	46%
Commercial Lines:			
Trucking	31%	29%	31%
Commercial Auto	12%	12%	11%
Property (including Liability)	10%	10%	10%
Other Specialty Lines	3%	2%	2%
Total Commercial Lines	56%	53%	54%
Total Gross Premiums Written	100%	100%	100%

	2005	2004	2003
Geographical Area			
United States:			
California	14%	14%	13%
Illinois	11%	10%	10%
Florida	10%	10%	12%
Texas	6%	8%	7%
New Jersey	3%	3%	2%
Alabama	2%	2%	2%
Pennsylvania	2%	2%	2%
Other	20%	22%	27%
Total United States	68%	71%	75%
Canada:			
Ontario	20%	17%	12%
Alberta	5%	5%	6%

Quebec	5%	5%	5%
Other	2%	2%	2%
Total Canada	32%	29%	25%
Total Gross Premiums Written	100%	100%	100%

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

13. Indebtedness and subsequent events:

(a) Bank indebtedness:

On February 23, 1999, the Company entered into a $100 million unsecured credit facility with a syndicate of banks. Under this facility the Company had the option to borrow at various rates. During each of the years ended December 31, 2003, 2002 and 2001 the Company repaid $5 million. The facility matured on March 5, 2004 and was fully repaid by the Company. In March, 1999, the Company entered into interest rate swap contracts which matured in March 2004 and had a fair value liability of $1,182,000 as at December 31, 2003.

On March 5, 2004, the Company entered into a C$150 million revolving credit facility with a syndicate of three banks. In December 2004 the facility was extended for a further 364 days and matures March 3, 2006. The facility bears interest at a floating rate based on the type of loan and the Company s senior unsecured debt rating. The amounts outstanding under this facility as at December 31, 2005, and December 31, 2004 were $11,178,000, with an effective interest rate of approximately 5%, and $59,902,000 with an effective interest rate of approximately 4%, respectively.

On February 15, 2006, the Company entered into a new C$150 million 364 day revolving credit facility with a syndicate of two banks that replaces the existing facility that had a maturity date of March 3, 2006. Depending on the type of loan, the facility bears interest at a floating rate that will be based on the Company s senior unsecured debt rating.

(b) Senior unsecured debentures:

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

On January 29, 2004, a subsidiary of the Company, Kingsway America Inc., completed the sale of $100 million 7.50% senior notes due 2014. The notes are fully and unconditionally guaranteed by the Company. The notes will be redeemable at Kingsway America s option on or after February 1, 2009. In March 2004 an additional $25 million of these senior notes were issued. Interest paid during the year was $9,375,000 and $4,818,000 for 2004.

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Notes to Consolidated Financial Statements

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

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

13. Indebtedness and subsequent events (continued):

(c) Subordinated indebtedness:

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of the Company issued $90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the rate of the London interbank offered interest rate for three month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will not exceed 12.45% to 12.75%. The Company has the right to call each of these securities at par anytime after five years from their issuance until their maturity. The net proceeds to the Company were $70,877,000 in 2003 after deducting expenses of $4,625,000.

(d) Loan payable:

On July 14, 2005 Kingsway Linked Return of Capital Trust (KLROC Trust) completed its public offering of C$78 million of 5.00% Kingsway Linked Return of Capital Preferred Units due June 30, 2015 of which the Company was a promoter. The net proceeds of the offering were used by KLROC Trust for a series of investments that included the purchase of a C$74.1 million 7.12% senior note due June 30, 2015 issued by an affiliate.

Kingsway America Inc., a U.S. subsidiary has a promissory note payable balance of approximately $66.2 million with Kingsway ROC LLC, an affiliated company. The note was issued on July 15, 2005 and bears interest at 7.37% annually. The note principal is payable on June 30, 2015. Quarterly interest instalments totaling approximately $4.9 million are due in 2006.

(e) Contractual obligations maturity profile:

The maturity profile of the Company s contractual obligations as described above in items (a) (d) is as follows:

Payments Due by Period

	2006	2007	2008	2009 & 2010	Thereafter	Total
Bank indebtedness	$11,767	$ --	$ --	$ --	$ --	$11,767
Senior unsecured debentures	--	67,068	--	--	125,000	192,068
Subordinated indebtedness	--	--	--	--	90,500	90,500
Loan payable	--	--	--	--	66,222	66,222
Total	$11,767	$67,067	--	--	$281,722	$360,557

14. Variable interest entities:

Variable interest entities include entities where the equity invested in the entity is considered insufficient to finance the entity s activities. The Company has two controlled entities which are variable interest entities and therefore not consolidated based on accounting standards as the Company is not considered to be the primary beneficiary. The Company accounts for its investment in these entities using the equity method and includes the investment in other assets of the Consolidated Balance Sheet. The Company s share of earnings in these entities is included in net investment income in the Consolidated Statement of Operations. As the funds invested in this non-consolidated affiliated entity formed part of the C$74.1 million note referred to in note 13(d), the effect of this transaction is to show additional debt on the Company s financial statements and an off-setting equity investment of C$8.3 million in the non-consolidated affiliated entity.

15. Commitments and contingent liabilities:

(a) Legal Proceedings:

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

(b) Statutory Requirements:

Statutory policyholders capital and surplus of the Company s insurance subsidiaries was $997.5 million and $838.5 million at December 31, 2005 and 2004, respectively.

The Company s subsidiaries are subject to certain requirements and restrictions under applicable state and provincial insurance legislation including minimum asset requirements and dividend restrictions. At December 31, 2005, under the various insurance regulatory restrictions, the Company s insurance and reinsurance subsidiaries have an aggregate dividend capacity of $377.0 million (2004 $298.1 million).

15. Commitments and contingent liabilities (continued):

(c) Letters of Credit:

On October 4, 2002 the Company entered into an annually renewable syndicated $350 million letter of credit facility. The letter of credit facility is principally used to collateralize inter-company reinsurance balances for statutory capital management purposes. The Company pledges securities to collateralize the utilized portion of the letter of credit facility. At December 31, 2005 and 2004 the letter of credit facility utilization was $227.3 million and $234.0 million, respectively.

Also, from time to time, the Company pledges securities to third parties to collateralize liabilities incurred under its policies of insurance. At December 31, 2005 and 2004, the amount of pledged securities was $39.4 million and $37.9 million, respectively.

(d) Charitable donations:

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

(e) Guarantee:

The Company provided a guarantee for a non-controlled affiliated entity which entered into a cross-currency swap transaction July 14, 2005 in conjunction with the Kingsway Linked Return of Capital Trust transaction described in note 13 (d) whereby the affiliate swapped fixed Canadian dollar payments for fixed U.S. dollar payments. The guarantee extends until the swap agreement terminates on June 30, 2015.

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

(f) Property:

Two of the Company s Canadian subsidiaries have formed a real estate joint venture which will be responsible for acquiring and construction of a real estate property that will eventually become the Company s principal office. The cost of this project is estimated to be approximately C$40 million.

In 2005, Lincoln General, a U.S. subsidiary acquired real estate property for the purpose of constructing a new principal office. The outstanding commitments related to this project were $10,862,390 at December 31, 2005.

16. Fair value disclosure:

The fair value of financial assets and liabilities, other than investments (note 3), unpaid claims (note 10) and interest rate swaps (note 13) approximate their carrying amounts.

17. Reconciliation of Canadian and United States Generally Accepted Accounting Principles:

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles (GAAP) in Canada. The significant differences between Canadian GAAP and U.S. GAAP, which affect the Company s consolidated financial statements, are described below:

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

	2005	2004	2003
Net income based on Canadian GAAP	$135,008	$101,014	$60,877
Impact on net income of U.S. GAAP adjustments, net of tax:			
Deferred start-up costs (a)	--	671	671
Equity accounting (b)	--	--	723
Gain on sale of USA Insurance Group (b)	--	--	(1,106)
Net income based on U.S. GAAP *	$135,008	$101,685	$61,165
Other comprehensive income adjustments:			
Change in unrealized gain on investments classified as available for sale (c)	(43,131)	20,092	20,472
Change in fair value of interest rate swaps (d)	--	1,182	4,323
Less: related future income taxes	(6,165)	6,973	9,074
Other comprehensive income adjustments	(36,966)	14,301	15,721
Currency translation adjustments in the period (e)	8,238	8,467	17,936
Other comprehensive income (loss)	(28,728)	22,768	33,657

Total comprehensive income	$106,280	$124,453	$94,822
*Basic earnings per share based on U.S. GAAP net income	$2.39	$1.81	$1.17
*Diluted earnings per share based on U.S. GAAP net income	$2.37	$1.80	$1.16

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

17. Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued):

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

	2005	2004
Shareholders equity based on Canadian GAAP	$804,715	$666,501
Other comprehensive income	6,615	43,581
Cumulative net income impact:		
Other	(821)	(821)
Shareholders equity based on U.S. GAAP	$810,509	$709,261

Statement of Financial Accounting Standards (SFAS) No. 130 Reporting Comprehensive Income requires the Company to disclose items of other comprehensive income in a financial statement and to disclose accumulated balances of other comprehensive income or loss in the equity section of the Company s consolidated balance sheet. Comprehensive income, which incorporates net income, includes all changes in equity during a period, except those resulting from investments by, and distributions to, owners. There is no requirement to disclose comprehensive income under Canadian GAAP. Total cumulative other comprehensive loss amounted to $16,573,000 and $45,301,000 as at December 31, 2005 and 2004, respectively.

(a) Deferred start-up costs:

Under Canadian GAAP, start-up costs of Avalon Risk Management, Inc. are deferred and amortized over a five year period commencing from the date the start-up period ended. Under U.S. GAAP, such costs are expensed in the periods in which the expenditures are incurred. These costs were fully amortized as at December 31, 2004.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

17. Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued):

(b) Equity accounting:

Under Canadian GAAP, the Company s 25% equity investment in USA Group was carried at cost as the Company did not have significant influence over the investee. Under U.S. GAAP the Company was deemed to have significant influence because the Company s equity investment exceeded 20%, and the equity method of accounting was used. This method recognized the Company s share of net income or loss of the investee. Also under U.S. GAAP goodwill is recognized and prior to December 31, 2001 was being amortized over a period of 10 years.

The Company disposed of its equity investment in USA Group in November, 2003 and had to reverse a portion of the gain under U.S. GAAP due to the difference in the cost base of the investment under Canadian and U.S. GAAP.

(c) Portfolio investments:

Under Canadian GAAP, portfolio investments are carried at cost or amortized cost, and where a decline in value of an investment is considered to be other than temporary, a write-down of the investment to its estimated recoverable amount is recorded. Under U.S. GAAP, such investments would be classified as available for sale and are marked to market after write-downs for other than temporary declines in values, and the unrealized gain or loss, net of any future income taxes, is recorded as other comprehensive income, a component of shareholders equity.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

17. Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued):

(d) Accounting for Derivative Instruments and Hedging Activities:

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), as amended by Statements No. 137 and 138, which established accounting and reporting standards for derivative instruments and for hedging activities. Under FAS 133, all derivative instruments, including certain derivative instruments embedded in other contracts, are recognized as either assets or liabilities in the balance sheet at their fair values, and changes in such fair values must be recognized immediately in earnings unless specific hedging criteria are met. The Company adopted this statement effective January 1, 2001 for purposes of its U.S. GAAP reconciliation. The Company purchased interest rate swap contracts that were designated as cash flow hedges against the amounts borrowed under the unsecured credit facility. The interest rate swaps matured in March, 2004. The terms of the swaps matched those of the unsecured credit facility, and were entered into to minimize the Company s exposure to fluctuations in interest rates. The change in the fair value of interest rate swap contracts is reflected in other comprehensive income.

(e) Currency translation adjustments:

The Company reports its results in U.S. dollars. The operations of the Company s subsidiaries in the Canada, Bermuda and its head office operations are self-sustaining. These subsidiaries hold all of their assets and liabilities and report their results in Canadian dollars. As a result, the assets and liabilities of these subsidiaries are translated at the year end rates of exchange. The unrealized gains and losses, which result from translation are deferred and included in shareholders equity under the caption currency translation adjustment . The currency translation account will change with fluctuations in the Canadian to U.S. dollar exchange rate.

(f) Future accounting pronouncements:

In December 2004, the U.S. Financial Accounting Standards Board issued a new standard amending the accounting for the stock-based compensation. The standard is effective for public companies starting with the first interim period commencing after June 15, 2005. It requires the use of a fair-value based method to measure and account for all stock options or other equity-based awards to employees or directors that vest or become exercisable after the effective date. The transition approach and impact of this change for the Company has not yet been determined.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

18. Comparative figures:

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

19. Supplemental Condensed Consolidating Financial Information:

In 2004, Kingsway America Inc. (KAI) issued senior notes which are fully and unconditionally guaranteed by the Company. The following is condensed consolidating financial information for the Company as of December 31, 2005 and 2004 and for the three years ended December 31, 2005, 2004 and 2003, with a separate column for each of KAI as Issuer, the Company (KFSI) as Guarantor and the other businesses of the Company combined (the Non-Guarantor Subsidiaries). For the purposes of the condensed consolidating financial information, the Company and KAI carry their investments under the equity method.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Operations
For the year ended December 31, 2005

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Revenue:					
Net premiums earned	$ --	$ --	$1,791,943	$ --	$1,791,943
Investment related income	(1,720)	4,400	128,594	--	131,274
Management fees	56,945	8,988	--	(65,933)	--
	55,225	13,388	1,920,537	(65,933)	1,923,217
Expenses:					
Claims incurred	--	--	1,241,202	(16,696)	1,224,506
Commissions and premium taxes	--	--	361,875	--	361,875
Other expenses	52,716	13,511	139,578	(49,237)	156,568
Interest expense	6,591	18,671	659	--	25,921
	59,307	32,182	1,743,314	(65,933)	1,768,870
Income before income taxes	(4,082)	(18,794)	177,223	--	154,347
Income taxes	2,755	(6,743)	23,327	--	19,339
	141,845	(319)	--	(141,526)	--

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Equity in undistributed net income of subsidiaries					
Net income	$135,008	$(12,370)	$ 153,896	$(141,526)	$ 135,008

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Operations
For the year ended December 31, 2004

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Revenue:					
Net premiums earned	$ --	$ --	$1,778,374	$ --	$1,778,374
Investment related income	(399)	3,086	91,971	--	94,658
Management fees	41,709	7,081	--	(48,790)	--
	41,310	10,167	1,870,345	(48,790)	1,873,032
Expenses:					
Claims incurred	--	--	1,272,483	(12,390)	1,260,093
Commissions and premium taxes	--	--	330,769	--	330,769
Other expenses	37,886	12,124	135,016	(36,400)	148,626
Interest expense	6,005	13,550	1,616	--	21,171
	43,891	25,674	1,739,884	(48,790)	1,760,659
Income before income taxes	(2,581)	(15,507)	130,461	--	112,373
Income taxes	2,944	(5,461)	13,876	--	11,359
Equity in undistributed net income of subsidiaries	106,539	3,383	--	(109,922)	--
Net income	$101,014	$ (6,663)	$ 116,585	$(109,922)	$ 101,014

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Operations
For the year ended December 31, 2003

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Revenue:					
Net premiums earned	$ --	$ --	$1,711,910	$ --	$1,711,910
Investment related income	(638)	18,162	80,168	--	97,692
Management fees	33,152	2,016	--	(35,168)	--
	32,514	20,178	1,792,078	(35,168)	1,809,602
Expenses:					
Claims incurred	--	--	1,285,093	(9,965)	1,275,128
Commissions and premium taxes	--	--	361,370	--	361,370
Other expenses	29,563	7,937	90,954	(25,203)	103,251
Interest expense	5,665	270	9,171	--	15,106
	35,228	8,207	1,746,588	(35,168)	1,754,855
Income before income taxes	(2,714)	11,971	45,490	--	54,747
Income taxes	(7,447)	4,038	(2,721)	--	(6,130)
Equity in undistributed net income of subsidiaries	56,144	9,656	--	(65,800)	--
Net Income	$60,877	$17,589	$ 48,211	$(65,800)	$ 60,877

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Balance Sheet
As at December 31, 2005

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Assets					
Investments in subsidiaries	$864,800	$380,764	$ 159,545	$(1,405,109)	$ --
Cash	2,831	9,597	98,606	--	111,034
Investments	191	2,967	2,800,632	--	2,803,790
Goodwill and other intangible assets	--	--	62,497	8,633	71,130
Other assets	19,666	43,250	2,254,733	(1,508,409)	809,240

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
	$887,488	$436,578	$5,376,013	$(2,904,885)	$3,795,194
Liabilities and Shareholders Equity					
Liabilities:					
Bank indebtedness	$ 11,178	$ 66,222	$ 589	$ --	$ 77,989
Other liabilities	4,527	19,563	114,451	(2,058)	136,483
Unearned premiums	--	--	1,059,190	(409,962)	649,228
Unpaid claims	--	--	2,931,723	(1,087,512)	1,844,211
Senior unsecured debentures	67,068	125,000	--	--	192,068
Subordinated indebtedness	--	90,500	--	--	90,500
	82,773	301,285	4,105,953	(1,499,532)	2,990,479
Shareholders equity:					
Share capital	331,470	157,391	1,132,861	(1,290,252)	331,470
Contributed surplus	3,237	--	--	--	3,237
Currency translation adjustment	9,958	--	45,101	(45,101)	9,958
Retained earnings	460,050	(22,098)	92,098	(70,000)	460,050
	804,715	135,293	1,270,060	(1,405,353)	804,715
	$887,488	$436,578	$5,376,013	$(2,904,885)	$3,795,194

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Balance Sheet
As at December 31, 2004

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Assets					
Investments in subsidiaries	$745,559	$359,480	$ 464,420	$(1,569,459)	$ --
Cash	3,935	1,871	81,297	--	87,103
Investments	122	--	2,495,586	--	2,495,708
Goodwill and other intangible assets	--	--	58,968	8,352	67,320
Other assets	25,756	40,384	2,172,989	(1,369,868)	869,261
	$775,372	$401,735	$5,273,260	$(2,930,975)	$3,519,392

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Liabilities and Shareholders Equity					
Liabilities:					
Bank indebtedness	$ 39,702	$ --	$ 20,200	$ --	$ 59,902
Other liabilities	4,277	18,608	167,988	(1,837)	189,036
Unearned premiums	--	--	1,005,091	(370,755)	634,336
Unpaid claims	--	--	2,639,551	(950,326)	1,689,225
Senior unsecured debentures	64,892	125,000	--	--	189,892
Subordinated indebtedness	--	90,500	--	--	90,500
	108,871	234,108	3,832,830	(1,322,918)	2,852,891
Shareholders equity:					
Share capital	328,544	177,674	1,128,481	(1,306,155)	328,544
Contributed surplus	1,769	--	--	--	1,769
Currency translation adjustment	1,720	--	36,232	(36,232)	1,720
Retained earnings	334,468	(10,047)	275,717	(265,670)	334,468
	666,501	167,627	1,440,430	(1,608,057)	666,501
	$775,372	$401,735	$5,273,260	$(2,930,975)	$3,519,392

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Cash Flows
For the year ended December 31, 2005

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Cash provided by (used in):					
Operating activities:					
Net income	$ 135,008	$ (12,370)	$ 153,896	$ (141,526)	$ 135,008
Adjustments to reconcile net income to net cash used by operating activities:					
Equity in undistributed earnings in subsidiaries	(141,845)	319		141,526	
Other	11,390	(1,506)	128,855		138,739
	4,553	(13,557)	282,751		273,747
Financing activities:					
Increase in share capital, net	2,926	(20,283)		20,283	2,926
Common share dividend	(9,426)				(9,426)
Increase/(decrease) in bank indebtedness	(28,532)	66,222	(20,312)		17,378

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Increase in senior unsecured indebtedness					
Increase in subordinated indebtedness					
	(35,032)	45,939	(20,312)	20,283	10,878
Investing activities:					
Purchase of investments	(9,053)	(24,436)	(2,556,529)		(2,590,018)
Proceeds from sale of investments	9,177	21,682	2,325,722		2,356,581
Purchase of subsidiaries, net of cash acquired	32,058	(23,934)	12,042	(32,058)	(11,892)
Other	(2,807)	2,032	(26,365)	11,775	(15,365)
	29,375	(24,656)	(245,130)	(20,283)	(260,694)
Increase (decrease) in cash during the year	(1,104)	7,726	17,309		23,931
Cash, beginning of year	3,935	1,871	81,297		87,103
Cash, end of year	$ 2,831	$ 9,597	$ 98,606	$	$ 111,034

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Cash Flows
For the year ended December 31, 2004

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Cash provided by (used in):					
Operating activities:					
Net income	$ 101,014	$ (6,663)	$ 116,585	$ (109,922)	$ 101,014
Adjustments to reconcile net income to net cash used by operating activities:					
Equity in undistributed earnings in subsidiaries	(106,539)	(3,383)		109,922	
Other	6,351	(8,796)	304,052	(10,961)	290,646
	826	(18,842)	420,637	(10,961)	391,660
Financing activities:					
Increase in share capital, net	2,434	(88,367)	54,313	34,054	2,434
Common share dividend					
Increase/(decrease) in bank indebtedness	23,709		(86,753)		(63,044)
Increase in senior unsecured indebtedness		125,000			125,000
Increase in subordinated indebtedness					

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
	26,143	36,633	(32,440)	34,054	64,390
Investing activities:					
Purchase of investments	(13,995)		(2,394,411)		(2,408,406)
Proceeds from sale of investments	15,482		1,943,801		1,959,283
Other	(42,812)	(20,199)	55,697	(23,093)	(30,407)
	(41,325)	(20,199)	(394,913)	(23,093)	(479,530)
Increase (decrease) in cash during the year	(14,356)	(2,408)	(6,716)		(23,480)
Cash, beginning of year	18,291	4,279	88,013		110,583
Cash, end of year	$ 3,935	$ 1,871	$ 81,297	$	$ 87,103

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements

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

Condensed Consolidating Statement of Cash Flows
For the year ended December 31, 2003

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Cash provided by (used in):					
Operating activities:					
Net income	$ 60,877	$ 17,589	$ 48,211	$ (65,800)	$ 60,877
Adjustments to reconcile net income to net cash used by operating activities:					
Equity in undistributed earnings in subsidiaries	(56,145)	(9,655)		65,800	
Other	40,735	(40,312)	426,421	(16,423)	410,421
	45,467	(32,378)	474,632	(16,423)	471,298
Financing activities:					
Increase in share capital, net	83,109	53,890	194,045	(247,935)	83,109
Common share dividend					
Increase/(decrease) in bank indebtedness	(2,868)		12,576		9,708
Increase in senior unsecured indebtedness					
Increase in subordinated indebtedness		75,500			75,500
	80,241	129,390	206,621	(247,935)	168,317
Investing activities:					
Purchase of investments	(21,729)	(5,617)	(4,656,300)	14,085	(4,669,561)
Proceeds from sale of investments	23,686	19,998	3,966,843		4,010,527

	KFSI (the Guarantor)	KAI (the Issuer)	Other subsidiaries (the Non-Guarantor subsidiaries)	Consolidation adjustments	Total
Other	(110,268)	(107,410)	(58,793)	250,273	(26,198)
	(108,311)	(93,029)	(748,250)	264,358	(685,232)
Increase (decrease) in cash during the year	17,397	3,983	(66,997)		(45,617)
Cash, beginning of year	894	296	155,010		156,200
Cash, end of year	$ 18,291	$ 4,279	$ 88,013	$	$ 110,583

Document No. 3

MANAGEMENT S DISCUSSION AND ANALYSIS

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this annual report. The commentary is current as of March 17, 2006. Our financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). See note 17 of the consolidated financial statements for a reconciliation of Canadian and United States GAAP. Additional information relating to Kingsway is available on SEDAR at www.sedar.com which can also be accessed from our website www.kingsway-financial.com. This annual report, including the following discussion, contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of several factors, including those set forth under the section entitled Risk Factors and elsewhere in this annual report.

From time to time, we make written and oral forward-looking statements, in this annual report, in other filings with Canadian regulators or the U.S. Securities and Exchange Commission (SEC), and in other communications. Forward-looking statements include, among others, statements regarding the Company s objectives and strategies to achieve them. Forward-looking statements are typically identified by words such as believe , expect , may and could . By their very nature, these statements are subject to inherent risks and uncertainties, general and specific, which may cause actual results to differ materially from the expectations expressed in the forward-looking statements. Some of the factors that could cause such differences are discussed under the section of this annual report entitled Risk Factors and in other regulatory filings made in Canada and with the SEC. The discussion of factors under the section entitled Risk Factors is not exhaustive of all possible factors, and other factors could also adversely affect the Company s results.

All such factors should be considered carefully when making decisions with respect to the Company, and undue reliance should not be placed on the Company s forward-looking statements. The Company does not undertake to update any forward-looking statements, written or oral, that may be made from time to time by or on its behalf.

All of the dollar amounts in this annual report are expressed in U.S. dollars, except where otherwise indicated. References to U.S. dollars , dollars or US$ are to U.S. dollars and any references to Canadian dollars or C$ are to Canadian dollars. As presented in this annual report, our Canadian and U.S. segment information includes the results of our Bermuda and Barbados reinsurance subsidiaries, respectively.

Exhibit Index appears on Page 151

Non-GAAP Measures

The Company uses both GAAP and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers about non-GAAP measures that do not have a standardized meaning under GAAP and are unlikely to be comparable to similar measures used by other companies. Kingsway, like many insurance companies, analyzes performance based on underwriting ratios such as combined, expense and loss ratios. These terms are defined in the glossary of terms section beginning on page 81 of the Annual Report. The Company also uses investment portfolio per share information which is calculated based on the fair value of the investment portfolio divided by the number of issued and outstanding common shares. The Company uses net operating income information which is calculated as net income excluding after-tax net realized gains and losses on investments. A reconciliation of net income to net operating income is presented below.

(In thousands of U.S. dollars)	**2005**	**2004**	**2003**
Net income, as reported	$ 135,008	$ 101,014	$ 60,877
Net realized gains before taxes, as reported	38,239	20,392	41,466
Tax effect on net realized gains	9,589	3,669	8,836
Net realized gains after tax	28,650	16,723	32,630
Net operating income	**$ 106,358**	$ 84,291	$ 28,247

Change in Reporting Currency

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

Overview

Our Company

Kingsway is a specialty provider of personal and commercial lines of property and casualty insurance in the United States and Canada. Our principal lines of business are trucking and non-standard automobile insurance. According to A.M. Best gross premiums written data, we are the largest truck insurer in North America and the seventh largest non-standard auto-mobile insurer in North America. We are also the largest writer of motorcycle insurance in Canada and the largest writer of taxi cab insurance in Chicago, Illinois and Las Vegas, Nevada.

Non-standard automobile insurance covers drivers who do not qualify for standard automobile insurance coverage because of their payment history, driving record, place of residence, age, vehicle type or other factors. Such drivers typically represent higher than normal risks and usually pay higher insurance rates for comparable coverage. We also provide standard automobile insurance as well as insurance for commercial and public vehicles, including taxis.

We also provide motorcycle insurance, specialized commercial and personal property coverages and other specialty coverages, such as customs, bail and surety bonds. For the year ended December 31, 2005, we derived 31% of our gross premiums written from trucking insurance, 29% from non-standard auto, 13% from commercial and personal property coverages, 12% from commercial automobile, 7% from standard automobile, 3% from motorcycle and 5% from other specialty lines.

We are the leading provider of non-standard automobile in Canada and have a prominent position in several U.S. markets in which we currently operate, such as Illinois and Florida. We are the third largest writer of non-standard automobile insurance in Illinois and the seventh largest in Florida according to A.M. Best data. We are the second largest writer of trucking insurance in the United States and a leading trucking insurer in Canada, making us the largest trucking insurer in North America according to A.M. Best data.

Kingsway Financial is the holding company for all of our subsidiaries and Kingsway America is the holding company for all of our U.S. operating subsidiaries. We operate our business through our insurance subsidiaries which include Kingsway General Insurance Company, York Fire & Casualty Insurance Company, and Jevco Insurance Company in Canada and Universal Casualty Company, Southern United Fire Insurance Company, American Service Insurance Company, Inc., Lincoln General Insurance Company, U.S. Security Insurance Company, American Country Insurance Company and Zephyr Insurance Company Inc. in the United States. We also have wholly owned reinsurance subsidiaries domiciled in Bermuda and Barbados. During the year ended December 31, 2005, we generated 68% of our gross premiums written from the United States and 32% from Canada.

In 2005, our gross premiums written were $1.89 billion, compared to $2.00 billion in 2004. Our return on equity averaged 15.0% for the five fiscal years 2001 to 2005, and for the year ended December 31, 2005, was 18.4% compared to 16.6% in 2004. As of December 31, 2005, we had total assets of $3.80 billion. During the year ended December 31, 2005, shareholders equity increased 21% to $804.7 million.

Our Industry

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

We use the claims ratio, the expense ratio and the combined ratio as important measures of our performance. The claims ratio is derived by dividing the amount of net claims incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions and premium taxes and general and administrative expenses by net premiums earned. The combined ratio is the sum of the claims ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates an underwriting loss. We believe that underwriting profit is the true measure of performance of the core business of a property and casualty insurance company. We have reported an underwriting profit in 13 years out of 16 since the Company s first full year of operations in 1990 and in four of the last five years. Management s incentive compensation is directly linked to our combined ratio and our return on equity objectives.

In recent years, the North American property and casualty insurance market, including the trucking and non-standard automobile markets, have been less price competitive than in the late 1990 s. Many insurers significantly reduced premium rates from 1998 to 2000 due to higher investment returns and an over-capitalization of the industry which subsequently led to poor underwriting results in 2001 and 2002, investment impairments and an erosion of capital. As a result, premium rates began to rise and the industry posted improved underwriting results for 2003 and 2004 but a slight deterioration is expected for 2005 based on available industry estimates.

Following the improved results in 2003 and 2004 certain automobile markets experienced pressure from governments to reduce premium rates in 2005. 2005 was also a year in which there was significant storm activity in the southern United States leading to a substantial loss of capital to reinsurers. Short-term interest rates also increased modestly during 2005 from historically low levels, but are still at levels which are much lower than those of the late 1990 s. As a result of these trends, we expect that 2006, like 2005, will be a year with good results, slow premium growth and increased reinsurance costs for insurance companies both in the United States and Canada. We believe insurance companies which have traditionally relied extensively on reinsurance capacity to support their premium levels will find this environment particularly challenging. We believe that the combination of these factors will lead to a modest deterioration in underwriting results for the property and casualty industry which will be partially offset by increased investment income in 2006.

Corporate Strategy

Our strategy is to specialize in areas of insurance where we have developed expertise such as trucking, non-standard automobile, motorcycle and taxis. We will then bring this expertise, underwriting discipline and knowledge to a broad range of geographic markets so our risks are well diversified.

Our strategy is to build long-term shareholder value and is characterized by the following principles:

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

Distinctive underwriting capabilities in target specialty markets. We manage our business with a strict focus on underwriting profit rather than on premium growth or market share and have demonstrated our willingness to increase pricing or reduce or increase premium volumes based on market conditions. Over the five year period ended December 31, 2005, our combined ratio averaged 99.1%. For the year ended December 31, 2005, our combined ratio was 97.2%.

We seek to identify market segments where we believe competition is more limited, presenting the potential for above average underwriting results. We operate through a network of regionally based operating subsidiaries. Our decentralized operating structure allows us to target specialized markets and products based on our underwriting expertise and knowledge of local market conditions.

We rely on our detailed understanding of our regional markets to take advantage of favourable conditions or trends. We look for opportunities to expand our specialty focus into selected regional markets and to increase the distribution of our core products in our existing territories. We may also look for opportunities to acquire books of business