KINGSWAY FINANCIAL SERVICES INC
Form 10-K
March 31, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

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x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-15204
Kingsway Financial Services Inc.
(Exact name of registrant as specified in its charter)

Ontario, Canada (State or other jurisdiction of incorporation or organization)	Not Applicable (I.R.S. Employer Identification No.)
45 St. Clair Avenue West, Suite 400 Toronto, Ontario	M4V 1K9
(Address of principal executive offices)	(Zip Code)

1-416-848-1171
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

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

As of June 30, 2013, the aggregate market value of the registrant's voting common stock held by non-affiliates of the registrant was $33,227,916 based upon the closing sale price of the common stock as reported by the New York Stock Exchange. Solely for purposes of this calculation, all executive officers and directors of the registrant are considered affiliates.

The number of shares of the Registrant's Common Stock outstanding as of March 31, 2014 was 16,429,761.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K is incorporated by reference to certain sections of the Proxy Statement for the 2014 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the end of our fiscal year ended December 31, 2013.

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Caution Regarding Forward-Looking Statements

This 2013 Annual Report on Form 10-K (the "2013 Annual Report"), including the accompanying consolidated financial statements of Kingsway Financial Services Inc. ("Kingsway") and its subsidiaries (individually and collectively referred to herein as the "Company") and the notes thereto appearing in Item 8 herein (the "Consolidated Financial Statements"), Management's Discussion and Analysis of Financial Condition and Results of Operations appearing in Item 7 herein (the "MD&A"), and the other Exhibits and Financial Statement Schedules filed as a part hereof or incorporated by reference herein may contain or incorporate by reference information that includes or is based on forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

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

- its results of operations and financial condition (including, among other things, premium volume, premium rates, net and operating income, investment income and performance, return on equity, and expected current returns and combined ratios);
- changes in facts and circumstances affecting assumptions used in determining the provision for unpaid loss and loss adjustment expenses;
- the number and severity of insurance claims (including those associated with catastrophe losses) and their impact on the adequacy of the provision for unpaid loss and loss adjustment expenses;
- the impact of emerging claims issues as well as other insurance and non-insurance litigation;
- orders, interpretations or other actions by regulators that impact the reporting, adjustment and payment of claims;
- changes in industry trends and significant industry developments;
- uncertainties related to regulatory approval of insurance rates, policy forms, license applications and similar matters;
- the impact of certain guarantees made by the Company;
- the ability to complete current or future acquisitions successfully;
- the ability to successfully implement our restructuring activities; and
- strategic initiatives.

For a discussion of some of the factors that could cause actual results to differ, see Item 1A,"Risk Factors," and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Estimates and Assumptions," in this 2013 Annual Report.

Except as expressly required by applicable securities laws, the Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, that might arise subsequent to the date of this 2013 Annual Report.

KINGSWAY FINANCIAL SERVICES INC.

Part I

Item 1. BUSINESS

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

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

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

Financial information about Kingsway's reportable business segments for the years ended December 31, 2013 and 2012 is contained in the following sections of this 2013 Annual Report: (i) Note 23, "Segmented Information," to the Consolidated Financial Statements; and (ii) "Results of Continuing Operations" section of MD&A.

REPORTING CURRENCY

The Consolidated Financial Statements have been presented in U.S. dollars because the Company's principal investments and cash flows are denominated in U.S. dollars. The Company's functional currency is the U.S. dollar since the substantial majority of its operations is conducted in the U.S. Assets and liabilities of subsidiaries with non-U.S. dollar functional currencies are translated to U.S. dollars at period-end exchange rates, while revenue and expenses are translated at average monthly rates and shareholders' equity is translated at the rates in effect at dates of capital transactions. Foreign exchange differences arising from the translations as described above are included in shareholders' equity under the caption accumulated other comprehensive income.

All of the dollar amounts in this 2013 Annual Report are expressed in U.S. dollars, except where otherwise indicated. References to "dollars" or "$" are to U.S. dollars, and any references to "C$" are to Canadian dollars.

GENERAL DEVELOPMENT OF BUSINESS

Rights Offering

On May 30, 2013, the Company announced that it had filed a registration statement for a proposed rights offering relating to transferable subscription rights to purchase up to approximately $13.1 million of its shares of common stock (the "Common Shares") and warrants to purchase Common Shares. The rights offering was made in the United States pursuant to a registration statement on Form S-1 that was previously filed with the Securities and Exchange Commission and became effective on July 24, 2013.

Under the rights offering, each shareholder of record as of August 9, 2013 (the "Record Date") received, at no charge, one subscription right for each Common Share owned on the Record Date (the "Subscription Right"). Four Subscription Rights entitled the holder to purchase one unit (a "Unit") consisting of one Common Share, one Series A Warrant (a "Series A Warrant") and one Series B Warrant (a "Series B Warrant", and together with the Series A Warrants, the "Warrants"). Each Warrant entitled the holder to purchase one Common Share. The subscription price was $4.00 per Unit. The exercise prices per Common Share for each Series A Warrant is $4.50 and for each Series B Warrant is $5.00. Each Series A Warrant is redeemable by the Company and has a term of seven years from its date of issuance. Each Series B Warrant is non-redeemable and has a term of ten years from its date of issuance. The Company may redeem the Series A Warrants at a price of $0.25 per Warrant if, and only if, the closing price of the Common Shares equals or exceeds $6.00 per Common Share for twenty consecutive trading days on the New York Stock Exchange ("NYSE") or such other market or exchange as the Common Shares of the Company trade on or are quoted at the time of redemption; but in any event, no earlier than the first anniversary date of issuance. Subject to applicable securities laws, the Warrants may be exercised at any time starting on the first day of the thirty-seventh month after the date of issuance until any time on or before the seventh anniversary after the date of issuance for the Series A Warrants and the tenth anniversary after the date of issuance for the Series B Warrants. Holders who fully exercise their Subscription Rights will be entitled to subscribe for an additional amount of Units, if any, that are not purchased by other shareholders or their transferees through the exercise of their basic subscription privileges, in an amount equal to up to five Units for each Unit for which such holder was otherwise entitled to subscribe.

On September 16, 2013, the transaction closed. Subscription rights to purchase 3,280,790 units were exercised, resulting in gross proceeds to the Company of $13.1 million. Net proceeds to the Company were $12.1 million after deducting commissions and other offering expenses. The Company used the proceeds from the rights offering to partially redeem the senior unsecured debentures due February 1, 2014. The partial early redemption was completed on October 15, 2013 in the amount of $12.0 million at par plus accrued interest of $0.2 million.

Acquisition

Effective May 22, 2013, the Company's subsidiary, Trinity Warranty Solutions LLC ("Trinity"), acquired certain intangible assets of Trinity Warranty Corp. for total consideration consisting of approximately $1.1 million in cash and future contingent payments. Trinity is a provider of warranty products and maintenance support to consumers and businesses in the heating, ventilation, air conditioning ("HVAC") and refrigeration industry. Further information is contained in Note 4, "Acquisitions," to the Consolidated Financial Statements.

Liquidations

During 2013, the Company's subsidiaries, Kingsway Reinsurance (Bermuda) Ltd. ("KRL") and Kingsway 2007 General Partnership ("2007 GP"), were liquidated. As a result of the liquidations of these subsidiaries, the Company realized a net after-tax gain of $7.2 million for the year ended December 31, 2013. This gain represents the foreign exchange gain previously recorded in accumulated other comprehensive income and now recognized in the consolidated statements of operations as a result of the liquidations of KRL and 2007 GP. Further information is contained in Note 5, "Liquidations, Disposition and Reacquisition," to the Consolidated Financial Statements.

INSURANCE UNDERWRITING SEGMENT

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

The insurance subsidiaries in Insurance Underwriting issue insurance policies and retain the risk of operating profit or loss related to the ultimate loss and loss adjustment expenses incurred on the underlying policies. Insurance Underwriting provides non-standard automobile and homeowners insurance to individuals and actively conducts business in 16 states. In 2013, the following states accounted for 85.7% of the Company's gross premiums written: Florida (22.2%), Illinois (14.7%), Texas (13.5%), Louisiana (11.1%), California (9.8%), Colorado (7.7%) and Nevada (6.7%).

Insurance Underwriting principally offers personal automobile insurance to drivers who do not meet the criteria for coverage by standard automobile insurers. For the year ended December 31, 2013, non-standard automobile accounted for 84.1% of the Company's gross premiums written.

During the fourth quarter of 2012, the Company began taking steps to place all of Amigo into voluntary run-off. On November 19, 2012, the Florida Office of Insurance Regulation (“OIR”) approved Amigo's plan to withdraw from the business of offering commercial lines insurance in Florida. On January 30, 2013, the OIR approved Amigo's plan to withdraw from the business of offering personal lines insurance in Florida. In April 2013, Kingsway filed a comprehensive run-off plan with the OIR, which outlines plans for Amigo's run-off. Kingsway continues to manage Amigo in a manner consistent with its filed run-off plan.

Insurance Underwriting Products

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

Table 1 and Table 2 summarize Insurance Underwriting's gross premiums written by line of business and by state, respectively, for the years ended December 31, 2013 and 2012.

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TABLE 1 Gross premiums written by line of business
For the years ended December 31 (in millions of dollars, except for percentages)

	2013	% of Total		2012	% of Total	
Private passenger auto liability	82.0	56.7	%	92.1	63.1	%
Auto physical damage	39.7	27.4	%	37.5	25.7	%
Total non-standard automobile	121.7	84.1	%	129.6	88.8	%
Commercial auto liability	—	—	%	6.0	4.1	%
Allied lines	13.9	9.6	%	10.3	7.1	%
Homeowners	9.1	6.3	%	—	—	%
Total gross premiums written	144.7	100.0	%	145.9	100.0	%

TABLE 2 Gross premiums written by state
For the years ended December 31 (in millions of dollars, except for percentages)

	2013	% of Total		2012	% of Total	
Florida	32.1	22.2	%	59.4	40.7	%
Illinois	21.2	14.7	%	24.1	16.5	%
Texas	19.6	13.5	%	15.5	10.6	%
Louisiana	16.0	11.1	%	2.5	1.7	%
California	14.2	9.8	%	10.0	6.9	%
Colorado	11.2	7.7	%	7.2	4.9	%
Nevada	9.7	6.7	%	7.3	5.0	%
Other	20.7	14.3	%	19.9	13.7	%
Total gross premiums written	144.7	100.0	%	145.9	100.0	%

Non-Standard Automobile

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

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

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

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

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For the year ended December 31, 2013, gross premiums written for non-standard automobile insurance decreased 6.1% to $121.7 million as compared to $129.6 million in 2012. Non-standard automobile insurance accounted for 84.1% and 88.8% of our gross premiums written for the years ended December 31, 2013 and 2012, respectively. The decrease in gross premiums written is the result of decreased premium volumes at Amigo, reflecting the actions begun by the Company during the fourth quarter of 2012 to place Amigo into voluntary run-off, partially offset by increased premium volumes at Maison, Mendota and Mendakota.

Commercial Automobile

Commercial automobile policies provide coverage for low-limit, light-weight, individual unit or small fleet commercial vehicles. For the year ended December 31, 2013, gross premiums written for commercial automobile insurance decreased by 100.0% to zero compared to $6.0 million in 2012. This decrease reflects the actions begun by the Company during the fourth quarter of 2012 to place Amigo into voluntary run-off.

Allied Lines

Allied lines includes policies that provide coverage for wind and hail-related property losses of residential dwellings and certain contents as well as premium related to Amigo's participation in the National Flood Insurance Program. The program is a cooperative undertaking of the insurance industry and the Federal Emergency Management Agency which allows participating property and casualty insurance companies to write and service the Standard Flood Insurance Policy in their own names. Under the program, Amigo receives an expense allowance for policies written and claims processed while the federal government retains responsibility for underwriting all losses. For the year ended December 31, 2013, gross premiums written from allied lines increased by 35.0% to $13.9 million compared to $10.3 million in 2012. This increase primarily reflects the Company's entry into the wind and hail-related insurance business in October of 2012 with the new business formation and licensing of Maison and subsequent participation in a depopulation of in-force wind and hail policies from Louisiana's state-owned insurance facility, Louisiana Citizens Property Insurance Corporation.

Homeowners

Homeowners premium includes dwelling, homeowner and mobile home/manufactured home policies for multi-peril property risks. For the year ended December 31, 2013, gross premiums written for homeowners insurance was $9.1 million compared to zero in 2012. This increase reflects Maison's entry into the homeowners insurance business during 2013.

Marketing and Distribution

Our strategy focuses on developing and maintaining strong relationships with our independent agents. Insurance Underwriting's products and services are marketed through approximately 4,500 independent agencies. We maintain an "open market" approach which enables these agents to place business with us without the obligation of minimum production commitments, providing us with a broad, flexible and scalable distribution network. We continually strive to provide excellent service in the markets in which we operate, communicating through a variety of channels as we look for opportunities to increase efficiency and reduce operating costs with our agents. Our independent agents have the ability to bind insurance policies on our behalf, subject to our insurance guidelines. Our proprietary point-of-sale systems, however, prevent any agent from binding an unacceptable risk. We do not, though, delegate authority to settle or adjust claims, except as relates to a third-party agreement specific to our homeowners business, establish underwriting guidelines, develop rates or enter into other transactions or commitments through our independent agents.

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

In December of 2012 and 2013, the Company participated in a depopulation of in-force wind and hail policies from Louisiana's state-owned insurance facility, Louisiana Citizens Property Insurance Corporation.

No material part of the business of Insurance Underwriting is dependent upon a single customer or group of customers, the loss of any one of which would have a material adverse effect on the Company, and no one customer or

group of affiliated customers accounts for 10% or more of the Company's consolidated revenues.
Competition
Insurance Underwriting operates in a highly competitive environment. Our core non-standard automobile offerings are policies at the minimum prescribed limits in each state produced entirely through our independent agents. We compete with large national

insurance companies and smaller regional insurance companies which produce through independent agents. We also compete with insurance companies which sell policies directly to their customers.
Large national insurance companies and direct underwriters typically operate in standard lines of personal automobile and property insurance in addition to non-standard lines and generally bring with them increased name recognition obtained through extensive media advertising, loyalty of the customer base to the insurer rather than to an independent agency and, potentially, reduced policy acquisition costs and increased customer retention.
From time to time, the non-standard automobile market attracts competition from new entrants. In many cases, these entrants are looking for growth and, as a result, price their insurance below the rates that we believe provide an acceptable return for the related risk. We firmly believe that it is not in our best interest to compete solely on price; consequently, we are willing to experience a loss of market share during periods of intense price competition or "soft" market conditions. During the last few years, the Company carried out a detailed review of its premium adequacy in the territories in which it operates and implemented steps to terminate business where premium adequacy was unlikely to be achieved within an acceptable period of time.
In order to stay competitive while striving to generate an economic rate of return, we compete on a number of factors such as distribution strength and breadth, premium adequacy, agency relationships, ease of doing business and market reputation. Ultimately, we believe that our ability to compete successfully in our industry is based, among other things, on our ability to:

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

The Company generally does not compete on the basis of ratings. In October, 2011 the Company had the A.M. Best ratings for all of its non-standard automobile insurance subsidiaries withdrawn. As a result, the Company's non-standard automobile insurance subsidiaries are currently unrated. Maison currently conducts business on the basis of a Demotech, Inc. Financial Stability Rating of A (“Exceptional”).
Underwriting
Our underwriting philosophy stresses receiving an adequate premium and spread of risks for the business we accept. We regularly monitor premium adequacy by territory, line of business and agency and take actions as necessary. Actions include, but are not limited to, tightening underwriting requirements, filing for rate increases, terminating underperforming programs and agents, non-renewing policies (where permitted) and other administrative changes. Typically, we do not reduce our premiums when competitors underwrite at premium rates that we believe are below acceptable levels. Instead, we focus on maintaining our premium per risk rather than writing a large number of risks at premiums that we believe would be inadequate and thus unprofitable. As a result, our premium volumes may be negatively impacted during a soft market.
Claims Management
Claims management is the process by which Insurance Underwriting determines the validity and amount of a claim. We believe that claims management is fundamental to our operating results. With respect to Insurance Underwriting, proper and efficient claims management has a direct effect on the operating profit or loss which has been retained related to the ultimate loss and loss adjustment expenses incurred on the underlying policies.
The individual operating subsidiaries in Insurance Underwriting primarily employ their own claims adjusters who are responsible for investigating and settling claims. Under certain circumstances, however, our operating subsidiaries will utilize each other's claims expertise where appropriate. In the case of Maison, we also rely on a third-party arrangement to assist us in settling claims. Our goal is to settle claims fairly for the benefit of our insureds in a manner that is consistent with the insurance policy language and our regulatory and legal obligations.
In addition to claims adjusters, our operating subsidiaries also employ appraisers, special investigators and salvage, subrogation and other personnel who are responsible for helping us reduce the net cost of claim-handling particularly

with respect to identifying instances of fraud. We aggressively combat fraud and have processes in place to investigate suspicious claim activity. We may also employ independent appraisers, private investigators, various experts and legal counsel to assist us in adjusting claims. When necessary, we defend litigation against our insureds generally by retaining outside legal counsel.

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INSURANCE SERVICES SEGMENT

Insurance Services includes the following subsidiaries of the Company: Assigned Risk Solutions Ltd. ("ARS"), IWS Acquisition Corporation ("IWS") and Trinity, (collectively, "Insurance Services"). During the first quarter of 2013, Northeast Alliance Insurance Agency, LLC, formerly included in Insurance Services, was merged into ARS.

ARS is a licensed property and casualty agent, full service managing general agent and third-party administrator focused primarily on the assigned risk market. ARS is licensed to administer business in 22 states but generates its revenues primarily by operating in the states of New York and New Jersey.

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

Trinity is a provider of warranty products and maintenance support to consumers and businesses in the HVAC and refrigeration industry. Trinity distributes its warranty products through original equipment manufacturers, HVAC distributors and commercial and residential contractors. Trinity distributes its maintenance support direct through corporate owners of retail spaces throughout the United States.

Insurance Services Products

ARS generally markets the same type of insurance products as Insurance Underwriting; however, ARS does not retain the risk of operating profit or loss related to the ultimate loss and loss adjustment expenses incurred on the underlying policies. This risk is borne by the insurance companies which partner with ARS in their marketing efforts.

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

In addition to marketing vehicle service agreements, IWS also brokers a guaranteed asset protection product (“GAP”) through its distribution channel. GAP generally covers a consumer's out-of-pocket amount, related to an automobile loan or lease, if the vehicle is stolen or damaged beyond repair. IWS earns a commission when a consumer purchases a GAP certificate but does not take on any insurance risk.

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

Marketing and Distribution

ARS markets its products through over 5,000 independent agencies. ARS' strategy focuses on developing and maintaining strong relationships with its assigned risk partners as well as the insurance companies which it represents. ARS' business is highly dependent upon its ability to provide excellent customer service in all facets of operations and by the market dynamics which determine the size of the assigned risk auto market pools in the states in which it competes. Many of these market dynamics are beyond ARS' control to meaningfully influence.

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

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

No material part of the business of Insurance Services is dependent upon a single customer or group of customers, the loss of any one of which would have a material adverse effect on the Company, and no one customer or group of affiliated customers accounts for 10% or more of the Company's consolidated revenues.

Competition

ARS operates in an environment with few market competitors but with more limited growth opportunities in the particular markets in which they compete. As ARS looks for more opportunities to grow beyond their current markets, they may begin to experience the more highly competitive environment described above for Insurance Underwriting.

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

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

Claims Management

Claims management is the process by which Insurance Services determines the validity and amount of a claim. We believe that claims management is fundamental to our operating results. With respect to ARS, even though the operating profit or loss related to the ultimate loss and loss adjustment expenses incurred on the underlying policies is retained by our insurance company partners, proper and efficient claims management has a direct effect on the operating profit or loss of our partners which consequently has a bearing on the strength of our continuing relationships and the opportunities for future growth. ARS also has negotiated contingent commission arrangements which enable it to participate economically in the profitable results of its partners.

The individual operating subsidiaries in Insurance Services primarily employ their own claims adjusters who are responsible for investigating and settling claims. Our goal is to settle claims fairly for the benefit of our insureds and the insureds of our insurance company partners in a manner that is consistent with the insurance policy language and our regulatory and legal obligations.

In addition to claims adjusters, ARS also employ appraisers, special investigators and salvage, subrogation and other personnel who are responsible for helping us reduce the net cost of claim-handling particularly with respect to identifying instances of fraud. We aggressively combat fraud and have processes in place to investigate suspicious claim activity. We may also employ independent appraisers, private investigators, various experts and legal counsel to assist us in adjusting claims. When necessary, we defend litigation against our insureds generally by retaining outside legal counsel.

IWS effectively and efficiently manages claims by utilizing in-house expertise and information systems. IWS employs an experienced claims staff comprised of Automotive Service Excellence certified mechanics, knowledgeable in all aspects of vehicle repairs and potential claims. Additionally, IWS owns its own proprietary database of historical claims data dating back over twenty years. Management analyzes this database to drive real-time pricing adjustments and strategic decision-making.

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

PRICING AND PRODUCT MANAGEMENT

Responsibility for pricing and product management rests with the Company's individual operating subsidiaries in each of Insurance Underwriting and Insurance Services. Typically, teams comprised of pricing actuaries, product managers and business development managers work together by territory to develop policy forms and language, rating structures, regulatory filings and new product ideas. Data solutions and claims groups track loss performance on a monthly basis so as to alert the operating subsidiaries to the potential need to adjust forms or rates.

UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

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

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

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

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

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

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

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

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

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

The exact boundary points of these ranges are more qualitative than quantitative in nature, as no clear line of demarcation exists to determine when the set of underlying assumptions for an estimation method switches from being reasonable to unreasonable. As a result, the Company does not believe that the endpoints of these ranges are or would be comparable across companies. In addition, potential interactions among the different estimation assumptions for different product lines make the aggregation of individual ranges a highly judgmental and inexact process.

A basic premise in most actuarial analyses is that past patterns demonstrated in the data will repeat themselves in the future, absent a material change in the associated risk factors discussed below. To the extent a material change affecting the ultimate provision for loss and loss adjustment expenses is known, such change is quantified to the extent possible through an analysis of internal company data and, if available and when appropriate, external data. Such a measurement is specific to the facts and circumstances of the particular claim portfolio and the known change being evaluated. Significant structural changes to the available data, product mix or organization can materially impact the provision for loss and loss adjustment expenses.

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

Variables Influencing the Provision for Unpaid Loss and Loss Adjustment Expenses

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

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

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

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

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

Claim complexity can also greatly affect the estimation process by impacting the number of assumptions needed to produce the estimate, the potential stability of the underlying data and claim process, and the ability to gain an understanding of the data. Product lines with greater claim complexity have inherently greater estimation uncertainty.

Actuaries have to exercise a considerable degree of judgment in the evaluation of all these factors in their analysis of the provision for loss and loss adjustment expenses. The human element in the application of actuarial judgment is unavoidable when faced with material uncertainty. Different actuaries may choose different assumptions when faced with such uncertainty, based on their individual backgrounds, professional experiences and areas of focus. Hence, the estimates selected by the various actuaries may differ materially from each other.

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

Property and Casualty Insurance

For the year ended December 31, 2013, non-standard automobile insurance accounted for 84.1% of the Company's gross premiums written. Non-standard automobile includes both short and long-tail coverages. The payments that are made quickly typically pertain to auto physical damage and property damage claims. The payments that take longer to finalize and are more difficult to estimate relate to bodily injury claims. Reporting lags are relatively short, and the claim settlement process for personal automobile liability generally is the least complex of the liability products. Given that our core non-standard automobile offerings are policies at the minimum prescribed limits in each state, our non-standard automobile business is generally viewed as a high frequency, low severity business.

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

- trends in jury awards;

- changes in the underlying court system and its philosophy;
- changes in case law;
- litigation trends;

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

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

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

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

The second section displays the cumulative amount of payments made through the end of each subsequent year with respect to each original provision. The third section presents the re-estimation over subsequent years of each year's original net liability for property and casualty unpaid loss and loss adjustment expenses as more information becomes known and trends become more apparent. For example, as of December 31, 2013, we had paid $188.8 million of the currently re-estimated provision of $192.9 million for property and casualty loss and loss adjustment expenses that had been incurred through the end of 2007 and which were originally estimated to be $197.7 million at December 31, 2007. As a result, an estimated $4.1 million of property and casualty loss and loss adjustment expenses incurred through December 31, 2007 remain unpaid as of December 31, 2013. The final section compares the latest re-estimation to the original estimate for each year presented in the table on both a gross and net basis.

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

Continuing with the December 31, 2007 example, the final section shows that the re-estimated net liability of $192.9 million reflected a cumulative $4.8 million redundancy in relation to the $197.7 million originally estimated at December 31, 2007.

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TABLE 3 Provision for property and casualty unpaid loss and loss adjustment expense, net of recoveries from reinsurers
As of December 31, 2013 (in millions of dollars, except percentages)

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003
Property and casualty unpaid loss and loss adjustment expenses originally established - end of year, gross	84.5	103.1	120.3	174.7	186.7	183.2	198.0	119.1	106.8	104.9	100.0
Less: reinsurance recoverable on property and casualty unpaid loss and loss adjustment expenses	7.9	5.5	0.3	8.0	—	0.5	0.3	0.3	0.5	0.3	0.4
Property and casualty unpaid loss and loss adjustment expenses originally established - end of year, net	76.6	97.6	120.0	166.7	186.7	182.7	197.7	118.8	106.3	104.6	99.6
Cumulative net paid as of:											
One year later		53.4	70.0	105.2	111.7	107.1	108.6	48.8	50.0	52.6	61.4
Two years later			99.4	141.2	155.5	156.8	150.5	75.5	71.0	73.3	83.6
Three years later				162.2	175.3	180.4	174.3	90.9	83.9	84.2	95.2
Four years later					188.0	190.8	183.6	98.8	91.3	90.0	101.3
Five years later						196.0	186.9	101.4	94.9	94.4	104.0
Six years later							188.8	102.7	96.1	95.9	107.7
Seven years later								103.0	97.4	96.5	108.4
Eight years later									97.6	97.6	108.7
Ni											