UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of report (Date of earliest event reported): **March 6, 2020**

KINGSWAY FINANCIAL SERVICES INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**001-15204**	**98-0475673**
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(IRS Employer Identification No.)

150 Pierce Rd., Itasca, IL 60143
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(416) 848-1171**

Not Applicable
(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, par value $0.01 per share	KFS	New York Stock Exchange

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

ITEM 4.01 Changes in Registrant's Certifying Accountant.

On March 6, 2020, Kingsway Financial Services Inc. (the "Company"), with the approval of the Audit Committee of the Company's Board of Directors (the "Audit Committee"), appointed Plante & Moran, PLLC ("Plante") as the Company's independent registered public accounting firm, subject to Plante's customary client acceptance procedures.

During the fiscal years ended December 31, 2018 and December 31, 2019, respectively, and the subsequent interim period through March 6, 2020, except as set forth below, neither the Company nor anyone on its behalf consulted with Plante regarding either (1) the application of accounting principles to any specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's financial statements, nor did Plante provide a written report or oral advice to the Company that Plante concluded was an important factor considered by the Company in reaching a decision as to the accounting, auditing or financial reporting issue; or (2) any matter that was either the subject of a disagreement (as defined in Item 304(a)(1)(iv) of Regulation S-K and the instructions related to Item 304 of Regulation S-K) or a reportable event (as defined in Item 304(a)(1)(v) of Regulation S-K). During the course of the audit of the Company's financial statements for the fiscal year ended December 31, 2018, certain material weaknesses in the Company's internal control over financial reporting were identified, as more particularly described in Item 9A to the Company's 2018 Annual Report on Form 10-K, which material weaknesses have not yet been remediated.

During the course of the audit of the Company's financial statements for the fiscal year ended December 31, 2018, the Company reassessed its accounting and concluded with respect to generally accepted accounting principles in the United States of America: (i) certain of the Company's limited liability investments previously accounted for under the equity method of accounting should have been consolidated; and (ii) a portion of the proceeds from the sale of redeemable Class A Preferred Stock issued on February 3, 2014 should have been allocated to the Series C Warrants and the beneficial conversion feature related to the embedded conversion option in the redeemable Class A Preferred Stock. Plante was subsequently engaged to provide consulting services that consisted of assisting management with the Company's determination and documentation of the Company's conclusions related to the accounting for the aforementioned items. Plante's memoranda provided to the Company in connection with such consultations are attached hereto as Exhibits 99.1 and 99.2, respectively. The Company was subsequently advised by its former accountant that the Company had a material weakness related to ineffective review controls over complex, nonrecurring transactions in which the original accounting for the aforementioned items were ultimately contributing factors in that determination. The Audit Committee discussed such material weakness with the Company's former accountant and there were no disagreements.

In addition to the foregoing, during the fiscal year ended December 31, 2018, Plante provided valuation services in connection with the purchase price allocation on an acquisition by the Company in 2017 and during the year ended December 31, 2019 assisted management in responding to auditor inquiries with respect thereto.

In approving the selection of Plante as the Company's independent registered public accounting firm for the year ended December 31, 2019, the Audit Committee considered existing and prior relationships between the Company and Plante and engaged in a dialogue with Plante regarding auditor independence issues. The Audit Committee determined that it was not aware of any relationships that could reasonably be expected to impact the objectivity or independence of Plante in performing audit services for the Company.

ITEM 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Exhibit Description
99.1	Memorandum from Plante & Moran, PLLC, dated May 13, 2019
99.2	Memorandum from Plante & Moran, PLLC, dated June 10, 2019

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

KINGSWAY FINANCIAL SERVICES INC.

March 12, 2020

By: /s/ Kent A. Hansen
Kent A. Hansen, Chief Financial Officer

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PURPOSE:

To document the considerations made in determining the accounting for Kingsway America Inc.'s and subsidiaries (the "Company") investments in the following limited liability companies ("LLC's").

Net Lease Investment Grade Portfolio, LLC ("NLIGP")
Flowers Portfolio 001, LLC ("Flowers")
DPM SPV, LLC ("DPM")
1347 Venture Opportunity LLC ("1347")

BACKGROUND AND INFORMATION ON LLC'S:

Related to the sale of Mendota Insurance Company ("Mendota") by Kingsway America Inc. ("KAI") or ("Kingsway") on October 18, 2018, a number of Mendota's investments in LLCs and LPs were either acquired by KAI or distributed to KAI at the closing by Mendota. As a result, operating agreements for the aforementioned entities that indicate ownerships interests of Mendota or its affiliates have been transferred to KAI as of the date of this evaluation.

Net Lease Investment Grade Portfolio, LLC

The Company currently holds a 70.9584% membership interest in NLIGP. The remaining interest is held by American Service Insurance Company (ASIC) (29.0416%). The operating agreement was executed in October 2015 and subsequently amended in Dec '17, April '18 and Oct '18. The Company (managing member) executed a management agreement with Oak Street Real Estate Capital GP II, LLC (Oak Street), who will provide management services and all significant operating activities of the LLC including the management of the investments in properties and future sales of such properties. Property investments made by NLIGP are made through individual LLC investments. NLIGP, which is audited and reports as an investment company, currently holds three LLC's (GNMN002, GSNC 002 and RPMLA002) each of which hold property encumbered by mortgage debt.

Flowers Portfolio 001, LLC

The Company holds 100% of the member interest in Flowers. The operating agreement was executed on December 16, 2014 and amended on July 31, 2018. The LLC executed an Investor Agreement in January 2015 with Oak Street Real Estate Capital, LLC (Oak Street). Under the agreement, Oak Street performs certain management functions on behalf of the LLC. Oak Street receives acquisition fees (2% of property purchase price) plus 20% of distributions after calculation of a 6% cumulative aggregate return on undistributed capital for the Company. Flowers holds six commercial properties under triple net leases. The properties are encumbered by mortgage loans.

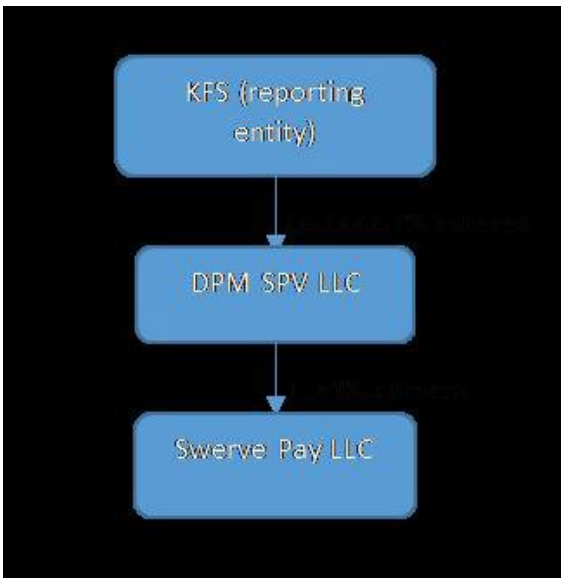
Operating Agreement

1st Amendment

Investor Agreement

DPM SPV, LLC

The Company holds a 66.6667% member interest in DPM. The remaining interest of 33.33333% is held by Mathew I. Gray Revocable Trust (Trust). The operating agreement was executed on December 16, 2015 and amended on December 29, 2017. DPM has invested $750,000 in Swerve Pay LLC, which is a software development firm for medical imaging software, and received 45,725 class B membership interest. DPM owns 8.42% of the total Class B membership interest which results in a 1.24% total interest. Swerve Pay LLC's capital structure includes Class A membership interest (investors who invested in early stage), Class B membership interest (subsequent to Class A investors) and Common Membership. Each Class A and Class B members have voting rights and liquidation preferences over common membership and can be converted into common equity at the option of the holder. Total number of fully diluted interests per the operating agreement are 3,687,377.



Amended Operating Agreement of DPM SI

Second AR Operating agreement - DPM SPV

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1347 Venture Opportunity LLC

The Company holds 100% of the member interest in 1347. The operating agreement was originally executed on October 10, 2014. The 7th amendment was executed in October 2018 (attached). 1347 has investments in equity securities and preferred securities directly or through LLC investments.

1347 Seventh Amendment

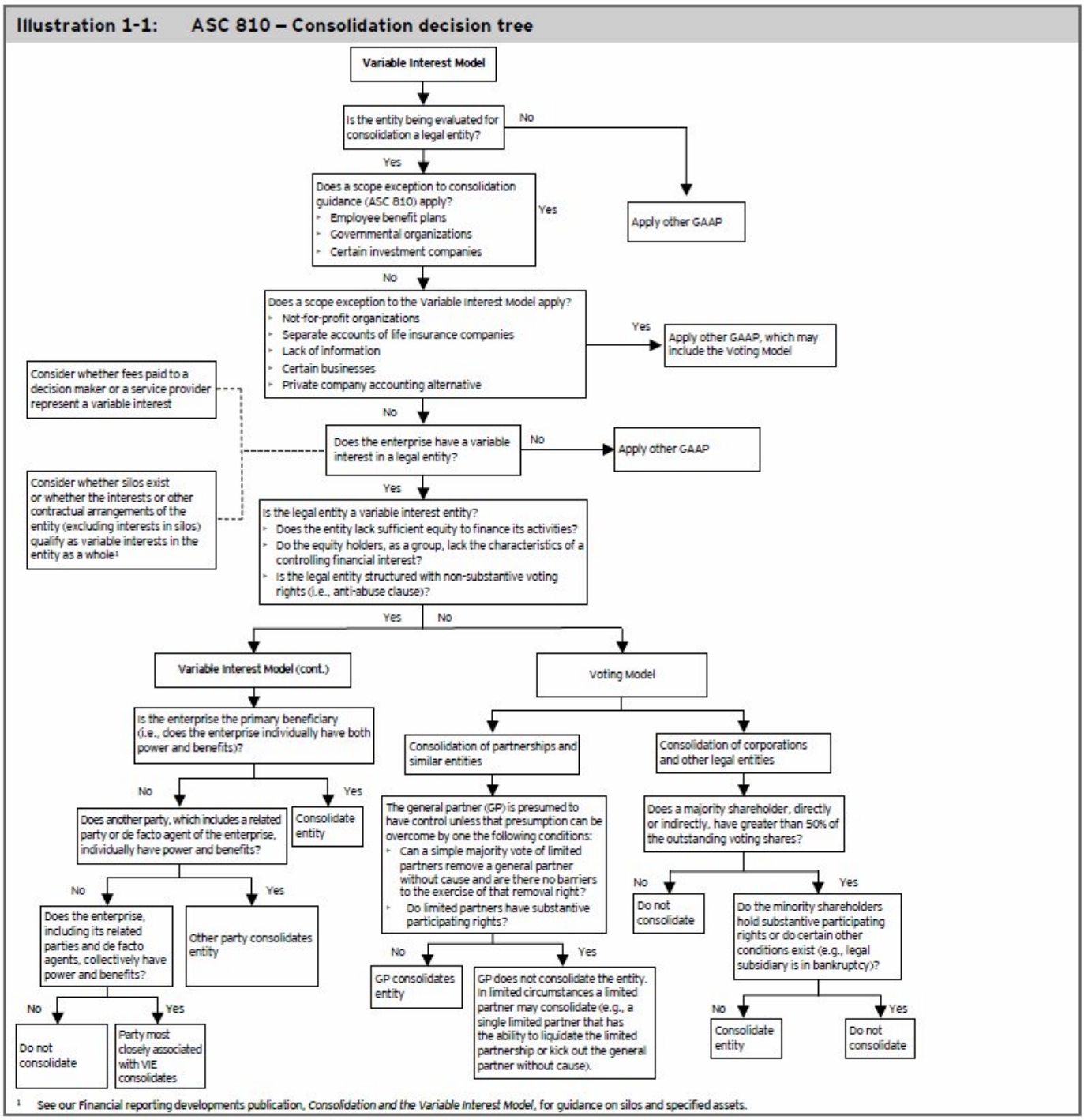
ACCOUNTING CONSIDERATIONS

Relevant Guidance – ASC 810. For purposes of this memo, we have reviewed all guidance within this topic, however, only references determined to be relevant to supporting the conclusion will be included.

810-10-05-1 The Consolidation Topic provides guidance on entities subject to consolidation as well as on how to consolidate.

05-3 Throughout this Subtopic, any reference to a **limited partnership** includes limited partnerships and similar **legal entities**. A *similar legal entity* is an entity (such as a limited liability company) that has governing provisions that are the functional equivalent of a limited partnership. In such entities, a managing member is the functional equivalent of a general partner, and a non-managing member is the functional equivalent of a limited partner.

The consolidation analysis begins with the variable interest model. The following flow chart excerpted from Ernst & Young's *Consolidated and Other Financial Statements* Financing Reporting Developments Guide, summarizes the key decision points in determining whether an entity should be consolidated. The analysis following will document the Company's significant considerations at each decision point.



VARIABLE INTEREST ENTITY ANALYSIS

Each of the entities involved in the analysis is a legal entity as evidenced by formation documents. We have documented a general overall understanding of the LLC's including ownership percentages in the background section above. We have also reviewed potential scope exceptions noted in ASC 810-10-15-12 and 810-10-15-17, noting none apply to the Company's investments in LLC's that would prevent consolidation.

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Evaluation of variable interests - The Company has made investments in each of the LLC's. An analysis of the nature of the legal entity's interests issued shall include consideration as to whether the terms of those interests, regardless of their legal form or accounting designation, transfer all or a portion of the risk or return (or both) of certain assets or operations of the legal entity to the holders of those interests. The variability that is transferred to those interest holders strongly indicates a variability that the legal entity is designed to create and pass along to its interest holders. Based on the nature of the equity interests held in the LLC's, which are all various types of investment vehicles for the Company, and the fact that the Company's capital account is at risk based on the operations of the LLC's, demonstrates that the Company has variable interests in each of the LLC's. In addition, there are debt holders within NLIGP and Flowers that have variable interests in the respective partnerships (debt). We have reviewed the LLC agreements and determined the debt holder's rights are limited to protective rights. In general, the LLC's cannot initiate material actions without the consent of the lender to permit the lender to protect its loan collateral. No decision-making authority is granted to lenders.

15-14 A legal entity shall be subject to consolidation under the guidance in the Variable Interest Entities Subsections if, by design, any of the following conditions exist.

a. The total equity investment (equity investments in a legal entity are interests that are required to be reported as equity in that entity's financial statements) at risk is not sufficient to permit the legal entity to finance its activities without additional **subordinated financial support** provided by any parties, including equity holders.

NLIGP – The LLC was initial financed with an investment of approximately $11.8 million and the LLC's acquisition of real estate and the related mortgage loan financing was completed independently (no guarantees required to induce lender). The mortgage debt was obtained solely based on the related real estate value. The intention was to organize the LLC at formation with sufficient capital to finance its activities with the option for additional capital contributions to fund additional investments as necessary. The total equity investment is deemed sufficient.

FLOWERS – The entity was set up with an initial investment of approximately $1.4 million and the LLC's acquisition of real estate and the related mortgage loan financing was completed independently (no guarantees required to induce lender). The mortgage debt was obtained solely based on the related real estate value. The total equity investment is deemed sufficient.

DPM – The initial capital contributions at or near formation of $1.5 million were combined with the noncontrolling interest capital contributions of $750,000. Since these capital contributions are pushing down to invest in a downstream LLC, the LLC isn't designed to require additional support as its only purpose is an investment vehicle. The total equity investment is deemed sufficient.

1347 – The initial capital contributions was $2.7 million. Since the member capital is being used to invest in various common and preferred securities, the LLC wouldn't require additional support as it is only an investor. The total equity investment is deemed sufficient.

b. As a group the holders of the equity investment at risk lack any one of the following three characteristics:

1. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance. (Including consideration of paragraph c regarding voting rights not proportional to obligations to absorb losses.)

2. The obligation to absorb the **expected losses** of the legal entity. The investor or investors do not have that obligation if they are directly or indirectly protected from the expected losses or are guaranteed a return by the legal entity itself or by other parties involved with the legal entity. See paragraphs 810-10-25-55 through 25-56 and Example 1 (see paragraph 810-10-55-42) for a discussion of expected losses.

3. The right to receive the **expected residual returns** of the legal entity. The investors do not have that right if their return is capped by the legal entity's governing documents or arrangements with other variable interest holders or the legal entity.

NLIGP – Kingsway and ASIC do not lack the power to direct activities affecting the LLC's economic performance. Section 8 of the LLC Agreement refers to Powers and indicates the Manager on behalf of the Company shall have and exercise all powers necessary to accomplish its purpose as set forth in Section 7. The Company, as successor of Mendota Insurance Company, is the Managing Member who, as described in Section 8, has the power to bind the company. Based on this arrangement, the Company maintains the ability to direct critical aspects of the LLC.

In accordance with Paragraph 15 of the LLC Agreement, profits and losses are solely allocated to the Members in accordance with their ownership interests. There are no other provisions that result in other entities absorbing losses or receiving residual returns. Members are listed in Exhibit A and include the Company and ASIC (see Amended and Restated Agreements for member interest percentages). Allocation of profits and losses demonstrates the reporting entity does not lack either the obligation to absorb expected losses or the right to received residual returns and confirms there are no disproportionate obligations to absorb losses with respect to voting interests.

FLOWERS – Kingsway as the sole member does not lack the power to direct activities affecting the LLC's economic performance. Section 8 of the LLC Agreement references the fact that the member has the power to do any and all acts necessary including authority to bind the Company. The member does have a responsibility to select an Independent Director as noted in Section 10. The Independent Director is in place to protect the Lender's Interest. The Independent Director cannot be removed as long as debt obligations remain. The Independent Director does not make decisions on behalf of the LLC but is in place to protect the lender from major actions that could negatively impact the lender's collateral. The LLC has also executed an Investor Agreement which identifies Oak Street as the entity to perform management functions on behalf of Kingsway; however, based on review of this agreement and the historical knowledge of the agreement design, there are no provisions that permit Oak Street to direct the activities of the LLC. Based on this arrangement, the Company maintains the ability to direct all critical aspects of the LLC.

In accordance with Section 14 of the LLC Agreement, profits and losses are allocated to the Member (for which there is only one member, the Company). There are no other provisions in the LLC Agreement that result in other entities absorbing losses or receiving residual returns. The Company signed an Investor agreement that in exchange for management of the LLC, Oak Street is awarded 20% of distributions after the Company is allocated a cumulative preferred return of 6%. This agreement does not cap the Company's ability to receive residual returns on its investment. This demonstrates the reporting entity does not lack either the obligation to absorb expected losses or the right to received residual returns and confirms there are no disproportionate obligations to absorb losses with respect to voting interests.

DPM – Kingsway and the Trust do not lack the power to direct activities affecting the LLC's economic performance. Article VIII of the LLC Agreement discusses how Members delegate the management of the Company's business, including the ability to bind the Company, to the Manager Daniel Malven (i.e., day to day activities). However, the Manager cannot take action on Major Decisions, which are defined in the agreement, without prior approval of 66.66% of the member interest support. Based on this arrangement, the Company maintains the ability to direct critical aspects of the LLC.

In accordance with Article IV of the LLC Agreement, profits and losses are allocated solely among Members in proportion to their participating percentages. There are no other provisions that result in other entities absorbing losses or receiving residual returns. This demonstrates the reporting entity does not lack either the obligation to absorb expected losses or the right to received residual returns and confirms there are no disproportionate obligations to absorb losses with respect to voting interests.

1347 – Kingsway, as the sole member, does not lack the power to direct activities affecting the LLC's economic performance. Management and control is vested in the "managers" as referenced in Article 6; however, the Company maintains control with the ability to appoint the manager, which currently includes an affiliated entity, 1347 Capital LLC. Based on this arrangement, the Company maintains the ability to direct critical aspects of the LLC. Based on Article 3, item 3.1 of the LLC Agreement, the holder of the member interests is entitled to profits, losses and distributions made by the Company as set forth in the agreement. There are no other provisions that result in other entities absorbing losses or receiving residual returns. This demonstrates the reporting entity does not lack either the obligation to absorb expected losses or the right to received residual returns and confirms there are no disproportionate obligations to absorb losses with respect to voting interests.

Conclusion: Based on the facts and circumstances present at the time of the formation of the entities and the information documented above, we have concluded the LLC's are not VIE's. Based on this result, the analysis continues through the voting model/control evaluation.

CONTROL GUIDANCE

25-1A Given the purpose and design of limited partnerships, **kick-out rights** through voting interests are analogous to voting rights held by shareholders of a corporation. Consolidation is appropriate if a reporting entity has a controlling financial interest in a limited partnership and a specific scope exception does not apply (see Section 810-10-15). The usual condition for a controlling financial interest in a limited partnership is ownership of a majority of the limited partnership's kick-out rights through voting interests, but, in some circumstances, control does not rest with the majority owner.

25-9 The following guidance addresses considerations of noncontrolling shareholder or limited partner rights, specifically protective rights and participating rights:

> > Protective Rights

25-10 Noncontrolling rights (whether granted by contract or by law) that would allow the noncontrolling shareholder or limited partner to block corporate or partnership actions would be considered protective rights and would not overcome the presumption of consolidation by the investor with a majority voting interest or limited partner with a majority of kick-out rights through voting interests in its investee.

> > Factors to Consider in Evaluating Whether Noncontrolling Rights Are Substantive Participating Rights

25-13 The following factors shall be considered in evaluating whether noncontrolling rights that appear to be participating are substantive rights, that is, whether these factors provide for effective participation in certain significant financial and operating decisions that are made in the investee's ordinary course of business:

a. Consideration shall be given to situations in which a majority shareholder or limited partner with a majority of kick-out rights through voting interests owns such a significant portion of the investee that the noncontrolling shareholder or limited partner has a small economic interest. As the disparity between the ownership interest of majority and noncontrolling shareholders or between the limited partner with a majority of kick-out rights through voting interests and noncontrolling limited partners increases, the rights of the noncontrolling shareholder or limited partner are presumptively more likely to be protective rights and shall raise the level of skepticism about the substance of the right. Similarly, although a majority owner is presumed to control an investee, the level of skepticism about such ability shall increase as the investor's or limited partner's economic interest in the investee decreases.

b. The governing documents shall be considered to determine at what level decisions are made—at the shareholder or limited partner level or at the board level—and the rights at each level also shall be considered. In all situations, any matters that can be put to a vote of the shareholders or limited partners shall be considered to determine if other investors, individually or in the aggregate, have substantive participating rights by virtue of their ability to vote on matters submitted to a shareholder or limited partner vote.

ASSESSMENT OF CONTROL

We have evaluated whether the Company has control over the LLC's listed below. In doing so, we have reviewed guidance within ASC 810, some of which is referenced above, and analyzed the various LLC agreements. Key considerations are summarized below.

NLIGP – The Company holds a 70.96% membership interest in NLIGP. The noncontrolling interest is held by an insurance company, ASIC, a subsidiary of Atlas Financial. The Company is the Managing Member, which in accordance with the LLC Agreement, provides the Company with control over the entity, subject to only lender restrictions for its investment properties encumbered by debt. Such restrictions are customary in lending relationships and in no way relinquish the Company's control. The noncontrolling interest is simply participating in profits and losses to the extent of their membership percentage. ASIC is not granted any authority within the LLC Agreement to block decisions made by the managing member or its agents. There are no board seats granted to ASIC or other avenues that would provide

ASIC with the ability to prevent significant actions by the Managing Member. Based on the lack of any significant powers awarded to the noncontrolling interest combined with the majority 70.96% interest held by the Company, control is apparent. **Based on evidence of control, the conclusion is made to consolidate NLIGP.**

Because NLIGP is an investment company, it does not consolidate non-investment companies under GAAP guidance (see audited financial statements of NLIGP). We evaluated whether the Company would have to "look through" and consolidate the underlying entities held by NLIGP. ASC 810-10-25-15 addresses the retention of specialized accounting for investments in consolidation.

25-15 For the purposes of consolidating a subsidiary subject to guidance in an industry-specific Topic, an entity shall retain the industry-specific guidance applied by that subsidiary.

In addition, this treatment was further confirmed in PWC's Financial Statement Presentation Guide:

18.6.3 Specialized industry accounting principles in consolidation

Reporting entities may encounter recognition and measurement complexities when consolidating subsidiaries that follow specialized industry accounting principles. For example, a private equity fund that is consolidated by its general partner may report its investments at fair value in its stand-alone fund financial statements in accordance with the specialized industry accounting principles in ASC 946, *Financial Services - Investment Company*.

Under ASC 810-10-25-15, reporting entities should retain specialized industry accounting in consolidation and related accounting policy disclosures, if material, assuming the specialized accounting practice is appropriate at the subsidiary level.

Based on this guidance, Company will retain the nature of the NLIGP financial statement presentation for purposes of its consolidation.

FLOWERS – The Company holds a 100% member interest in the LLC. As the sole member of an LLC, we believe the assessment would be similar to assessing control of a corporation as opposed to analogizing to limited partnership kick-out rights (no situation for a LP to replace the GP in this case). We consider the critical aspects of this analysis to be that of majority voting rights and the absence of substantive participating rights from third parties. The LLC Agreement is clear that the Company has complete control over the entity, subject to only lender restrictions on properties encumbered by debt. Such restrictions are customary in lending relationships and in no way relinquish the Company's control over the LLC. However, based on the Investor Agreement signed with Oak Street, who manages the activities of the LLC, we have further evaluated whether this entity has substantive participating rights. The guidance included in paragraph 25-11 was considered when assessing whether participating rights are held by Oak Street.

Participating Rights (Voting Interest Entity Definition) Participating rights allow the limited partners or noncontrolling shareholders to block or participate in certain significant financial and operating decisions of the limited partnership or corporation that are made in the ordinary course of business.

Analysis: The Investor agreement is very limited in its scope and does not directly enumerate specific responsibilities of Oak Street other than performing management functions on behalf of Kingsway. The primary aspect of the agreement is to set forth the nature of the fees payable (or potentially payable) to Oak Street. The Investor agreement acknowledges that Kingsway is the sole equity member of the LLC, and we believe the absence of specific decision-making authority in the agreement would lead to the presumption that no such authority has been granted to an entity that holds no equity interest in the LLC. However, we have evaluated the nature of the day-to-day activities to confirm no participating rights are held by Oak Street. The activities of the LLC include management of properties under triple-net-leases and day-to-day activities are minimal.

We first considered whether Kingsway could unilaterally direct the activities of Flowers. For example, could Kingsway direct Oak Street to sell a particular property or would Oak Street have the ability to block that type of decision? Alternatively, can Oak Street compel the LLC to do a particular deal despite Kingsway's objection?

Kingsway has the authority to unilaterally direct the activities of Flowers through the Oak Street manager. Kingsway can direct the sale of properties, subject only to the lender restrictions and satisfaction. Oak Street does not have the ability to block that type of decision. Oak Street in no way can compel the LLC to do a particular transaction or activity.

We further assessed where there is any decision-making authority as it relates to the day-to-day activities of the LLC. As a limited purpose triple-net-lease investment holding, there are limited day-to-day activities; however, the process of lease renewal was considered to be a relevant example of a significant operating decision. As the property manager, Oak Street will evaluate the renewal and provide a recommendation to Kingsway in addition to coordinating approvals with the lender. Oak Street provides Kingsway with significant communications and requests approval from Kingsway before such actions are taken. There were no lease extensions/renewals done for any of the 6 properties within the LLC structure; however, a similar structure is in place for Oak Street to act as agent for NLIGP and there is email evidence of the Kingsway approvals taking place. The email correspondence supports the Company's assertion that Oak Street is solely acting as the Company's agent and; therefore, does not have substantive participating rights.

We also considered the fact that the Company cannot unilaterally amend the Investor Agreement, resulting in the inability of the Company to replace Oak Street, and whether that provides Oak Street with substantive participating rights. The provision was put in place to protect Oak Street's fee structure in the Investor Agreement which provides for potential profit sharing to Oak Street in the event the LLC's profits are in excess of the 6% cumulative return for Kingsway. While this provision ensures Oak Street will not be replaced by the Company, it does not provide Oak Street with any decision-making authority or ability to block Kingsway decisions on significant financial or operating decisions.

Summary: There are no instances where Oak Street would have the capacity to make significant financial and operating decisions for the LLC. Oak Street is not an equity holder of the entity as acknowledged in the Investor Agreement and the Investor agreement provides no indication of granting any specific decision-making authority to Oak Street. There is no evidence in the agreements or in practice that would provide evidence of substantive participating rights by Oak Street.

Based on evidence of control and no significant participating rights, the conclusion is made to consolidate Flowers.

DPM – The Company holds a 66.66667% interest in the LLC which in turn has a 1.24% interest in Swerve Pay LLC. We first considered control of DPM. Based on the LLC Agreement, the Company with its 2/3 member interest has the ability to make all major decisions for the LLC irrespective of the noncontrolling interest, except as otherwise specifically stated in the LLC Agreement. There are only limited situations (listed below) within the LLC Agreement that would require unanimous consent from all members (as opposed to 66.66%), none of which have been determined to be substantive participating rights limiting the Company's control:

- Listing on public exchange (2.3)
- Sell, transfer, encumbering membership interest, however, consent should not be unreasonably withheld (11.1)
- Admission of new members (14.1)

Based on evidence of control, the conclusion is made to consolidate DPM.

In addition, DPM has an investment in Swerve Pay LLC. DPM's voting interest is in Swerve Pay LLC is 1.24%, a noncontrolling interest that does not require consolidation into DPM. The Company does not have access to financial information (i.e. books and records), it has an insignificant voting interest, and there are no factors that would indicate "significant influence" in accordance with ASC 323. **The Company has determined Swerve Pay LLC to be a cost method investment of DPM.**

1347 – The Company holds a 100% member interest in the LLC. As the sole member, the Company has complete control over the entity and rights and obligations to profits and losses of the entity. **Based on evidence of control, the conclusion is made to consolidate 1347.**

May 13, 2019

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PURPOSE

To document the considerations made in determining the accounting for Kingsway Financial Services Inc.'s (the "Company") issuance of convertible preferred stock and warrants on February 3, 2014.

BACKGROUND

On December 20, 2013, the Company entered into subscription agreements to issue and sell in a private placement (the "Private Placement") to accredited investors an aggregate of 262,876 units of the Company ("Units"), at a purchase price of $25.00 per Unit, for aggregate proceeds of approximately $6.6 million. Each Unit consisted of (i) one Class A Preferred Share, Series 1 (the "Series 1 Shares") and (ii) 6.25 Common Share Series C Warrants (the "Series C Warrants"). The Units were offered and sold without registration under the Securities Act of 1933, as amended (the "Securities Act"), in reliance upon the exemption from registration under Section 4(a)(2) of the Securities Act and/or Rule 506 of Regulation D promulgated thereunder. The closing of the Private Placement occurred on February 3, 2014 ("Closing").

At the Closing, the Company entered into a Common Stock Series C Warrant Agreement (the "Series C Warrant Agreement") with Computershare Trust Company of Canada, as warrant agent ("Computershare"), governing the terms and conditions of the Series C Warrants. The Series C Warrant Agreement provided that each Series C Warrant entitles the holder thereof to purchase one Common Share of the Company at an exercise price of $5.00 per share beginning on September 16, 2016 and prior to the expiration of the Series C Warrants on September 15, 2023 (the "Expiration Date"). The maximum number of Common Shares permitted to be issued pursuant to the exercise of the Series C Warrants is 1,642,975 Common Shares. The Series C Warrants are nonredeemable by the Company.

The exercise price and number of Common Shares issuable upon exercise of the Series C Warrants are subject to proportionate adjustment in the event of any stock splits, stock dividends, reorganizations, recapitalizations in respect of the common stock of the Company.

On February 3, 2014, the Company received an aggregate $6,572,080 in proceeds and issued 262,876 Series 1 Shares and 1,642,975 Series C Warrants. At the Closing, the Company recorded the Series 1 Shares at the aggregate amount of proceeds received within mezzanine equity, as determined in a separate KFS Private Placement memo to audit file dated March 12, 2015.

The Series C Warrants were subject to a mandatory exchange procedure in which the Series C Warrants would be exchanged for newly issued Common Share Series B Warrants of the Company (the "Series B Warrants"), which class of warrants of the Company was listed on the Toronto Stock Exchange (the "TSX") at the time of Closing and have identical terms to the Series C Warrants. The Common Stock Series B Warrant Agreement, ("Series B Warrant Agreement") dated as of September 16, 2013, between the Company and Computershare was amended to increase the maximum number of Series B Warrants that may be issued thereunder to allow for the issuance of a sufficient number of additional Series B Warrants to be issued in exchange for the Series C Warrants. On July 8, 2014, the Series C Warrants outstanding were automatically exchanged for an equal number Series B Warrants.

ACCOUNTING CONSIDERATIONS

The first consideration is whether any of the proceeds received at Closing should have been re-allocated from the Series 1 Shares to the Series C Warrants. The next consideration is how that re-allocated amount should have been calculated,

and what effect that re-allocation would have had on the recorded value of the Series 1 Shares. The final consideration is, if proceeds had been allocated to the Series C Warrants, what effect, if any, the exchange into Series B Warrants would have had on the financial statements of the Company.

Relevant Guidance – ASC 480, ASC 815, and ASC 470. For purposes of this memo, we have reviewed all guidance within these topics, however, only references determined to be relevant to supporting the conclusion will be included.

The analysis begins by determining whether the Series C meet the definition of freestanding financial instruments. Next, the Series C Warrants should be analyzed to determine whether they are in scope of ASC 480. If not, it should be determined whether the Series C Warrants are in the scope of ASC 815, including analysis of whether the "own equity" scope exceptions to ASC 815 are met. Finally, the classification of the Series C Warrants and the effect of the Series C Warrants on the Series 1 Shares should be determined.

ASC Master Glossary, Freestanding Financial Instrument A financial Instrument that meets either of following conditions:

a. It is entered into separately and apart from any of the entity's other financial instruments or equity transactions.
b. It is entered into in conjunction with some other transaction and is legally detachable and separately exercisable.

480-10-25-8 An entity shall classify as a liability (or an asset in some circumstances) any financial instrument, other than an outstanding share, that, at inception, has both of the following characteristics:

a. It embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation.
b. It requires or may require the issuer to settle the obligation by transferring assets.

480-10-25-9 In this Subtopic, *indexed to* is used interchangeably with *based on variations in the fair value of*. The phrase requires or may require encompasses instruments that either conditionally or unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant.

480-10-25-14 A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the obligation is based solely or predominantly on any one of the following:

a. A fixed monetary amount known at inception (for example, a payable settleable with a variable number of the issuer's equity shares)
b. Variations in something other than the fair value of the issuer's equity shares (for example, a financial instrument indexed to the Standard and Poor's S&P 500 Index and settleable with a variable number of the issuer's equity shares)
c. Variations inversely related to changes in the fair value of the issuer's equity shares (for example, a written put option that could be net share settled)…

815-10-15-83 A derivative instrument is a financial instrument or other contract with all of the following characteristics:

a. Underlying, notional amount, payment provision. The contract has both of the following terms, which determine the amount of the settlement or settlements, and, in some cases, whether or not a settlement is required:
    1. One or more underlyings
    2. One or more notional amounts or payment provisions or both.
b. Initial net investment. The contract requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
c. Net settlement. The contract can be settled net by any of the following means:
    1. Its terms implicitly or explicitly require or permit net settlement.
    2. It can readily be settled net by a means outside the contract.

3. It provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

815-10-15-74 A Notwithstanding the conditions of paragraphs 815-10-15-13 through 15-139, the reporting entity shall not consider the following contracts to be derivative instruments for purposes of this Subtopic:

a. Contracts issued or held by that reporting entity that are both:
   a. Indexed to its own stock
   b. Classified in stockholders' equity in its statement of financial position…

470-20-25-2 Proceeds from the sale of a debt instrument with stock purchase warrants (detachable call options) shall be allocated to the two elements based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The portion of the proceeds so allocated to the warrants shall be accounted for as paid-in capital. The remainder of the proceeds shall be allocated to the debt instrument portion of the transaction. This usually results in a discount (or, occasionally, a reduced premium), which shall be accounted for under Topic 835 [Interest].

ANALYSIS OF WARRANTS

Freestanding Financial Instruments

The Series C Warrants were entered into in conjunction with the Series 1 Shares and are legally detachable and separately exercisable. **Conclusion:** The Series C Warrants meet the definition of freestanding financial instruments and some of the proceeds at Closing should be allocated to the Series C Warrants.

Scope of ASC 480

Because the Series C Warrants contain no repurchase provisions and do not unconditionally or conditionally require the transfer of cash or other assets, they are not within scope of ASC 480-10-25-8 through 25-9. Because the Series C Warrants are settled with a fixed number of Common Shares for a fixed monetary amount per Common Share, the criteria of ASC 480-10-25-14 are not met and the Series C Warrants are not in scope of ASC 480. **Conclusion:** The Series C Warrants are not required to be recorded as a liability in accordance with ASC 480.

Definition of a Derivative

The underlying of Series C Warrants is Common Shares of the Company, and the notional amount is $5.00 per share.

815-10-15-95 A derivative instrument does not require an initial net investment in the contract that is equal to the notional amount (or the notional amount plus a premium or minus a discount) or that is determined by applying the notional amount to the underlying. The price paid per Unit was $25.00, while the Series C Warrants comprising each unit allow for the purchase of 6.25 Common Shares for an aggregate price of $31.25. Because the price paid for the Series C Warrants is less than their aggregate notional, the Series C Warrant Agreement did not require an initial net investment. Because the underlying of the Series C Warrants is Common Shares of the Company, the Series C Warrant Agreement provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement. **Conclusion:** The Series C Warrants meet the definition of a derivative per ASC 815.

Scope Exception to ASC 815

815-40-15-7 An entity shall evaluate whether an equity-linked financial instrument (or embedded feature), as discussed in paragraphs 815-40-15-5 through 15-8 is considered indexed to its own stock within the meaning of this Subtopic and paragraph 815-10-15-74(a) using the following two-step approach:

a. Evaluate the instrument's contingent exercise provisions, if any.
b. Evaluate the instrument's settlement provisions.

Contingent Exercise Provisions

The Series C Warrants do not contain any contingent exercise provisions.

Settlement Provisions

815-40-15-7F An instrument (or embedded feature) shall not be considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares. An instrument (or embedded feature) shall not be considered indexed to the entity's own stock if either:

a. The instrument's settlement calculation incorporates variables other than those used to determine the fair value of a fixed-for-fixed forward or option on equity shares.
b. The instrument contains a feature (such as a leverage factor) that increases exposure to the additional variables listed in the preceding paragraph in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares.

815-40-15-7G Standard pricing models for equity-linked financial instruments contain certain implicit assumptions. One such assumption is that the stock price exposure inherent in those instruments can be hedged by entering into an offsetting position in the underlying equity shares. For example, the Black-Scholes-Merton option-pricing model assumes that the underlying shares can be sold short without transaction costs and that stock price changes will be continuous. Accordingly, for purposes of applying Step 2, fair value inputs include adjustments to neutralize the effects of events that can cause stock price discontinuities. For example, a merger announcement may cause an immediate jump (up or down) in the price of shares underlying an equity-linked option contract. A holder of that instrument would not be able to continuously adjust its hedge position in the underlying shares due to the discontinuous stock price change. As a result, changes in the fair value of an equity-linked instrument and changes in the fair value of an offsetting hedge position in the underlying shares will differ, creating a gain or loss for the instrument holder as a result of the merger announcement. Therefore, inclusion of provisions that adjust the terms of the instrument to offset the net gain or loss resulting from a merger announcement or similar event do not preclude an equity-linked instrument (or embedded feature) from being considered indexed to an entity's own stock.

The exercise price and number of Common Shares issuable upon exercise of the Series C Warrants are subject to proportionate adjustment in the event of any stock splits, stock dividends, reorganizations, recapitalizations in respect of the common stock of the Company. This additional variable would be considered an input to the fair value of a fixed-for-fixed forward or option on equity shares. **Conclusion:** The Series C Warrants are not precluded from being considered indexed to the Company's own stock.

Requirements for Equity Classification

815-40-25-10 Because any contract provision that could require net cash settlement precludes accounting for a contract as equity of the entity (except for those circumstances in which the holders of the underlying shares would receive cash, as discussed in the preceding two paragraphs and paragraphs 815-40-55-2 through 55-6), all of the following conditions must be met for a contract to be classified as equity:

a. Settlement permitted in unregistered shares. The contract permits the entity to settle in unregistered shares. According to Clause 4.7(b) of both the Series C and Series B Warrant Agreements, "The Series C Warrants shall not be exercisable and the Company shall not be obligated to issue Warrant Shares unless, at the time a holder seeks to exercise the Series C Warrants, a prospectus relating to Warrant Shares is current and a registration statement for the Warrant Shares is effective or qualified or the issuance of Warrant Shares is deemed to be exempt under the securities laws of the jurisdiction of residence of the holder of the Series C Warrants." At the Closing, because the Private Placement was offered only to accredited investors, all holders of the Series C Warrants were exempt under the securities laws of their jurisdictions. Accordingly, settlement in unregistered shares is permitted.
b. Entity has sufficient authorized and unissued shares. The entity has sufficient authorized and unissued shares available to settle the contract after considering all other commitments that may require the issuance of stock

during the maximum period the derivative instrument could remain outstanding. At the Closing, the Company's authorized and unissued shares were sufficient to cover the exercise of all Series C Warrants issued.

c. Contract contains an explicit share limit. The contract contains an explicit limit on the number of shares to be delivered in a share settlement. According to the Private Placement, the maximum number of Common Shares permitted to be issued pursuant to the exercise of the Series C Warrants is 1,642,975 Common Shares.

d. No required cash payment if entity fails to timely file. There are no required cash payments to the counterparty in the event the entity fails to make timely filings with the Securities and Exchanges Commission (SEC). There are no required cash payments to the holders of the Series C Warrants in the event the entity fails to make timely filings with the SEC.

e. No cash-settled top-off or make-whole provisions. There are no cash settled top-off or make-whole provisions. There are no cash settled top-off or make-whole provisions in the Series C Warrant Agreement.

f. No counterparty rights rank higher than shareholder rights. There are no provisions in the contract that indicate that the counterparty has rights that rank higher than those of a shareholder of the stock underlying the contract. There are no provisions in the Series C Warrant Agreement that indicate that the holder has rights that rank higher than those of a common stock shareholder.

g. No collateral required. There is no requirement in the contract to post collateral at any point or for any reason. There is no requirement in the Series C Warrant Agreement to post collateral at any point or for any reason.

Conclusion: The Series C Warrants meet the additional requirements for equity classification and therefore qualify for the scope exceptions to ASC 815.

Allocation of Proceeds between Series 1 Shares and Series C Warrants

According ASC 470-20-25-2, proceeds from the sale of a debt instrument with stock purchase warrants should be allocated to the two elements based on the relative fair values of the debt instrument without the warrants and of the warrants themselves at time of issuance. The portion of the proceeds so allocated to the warrants should be accounted for as paid-in capital. The remainder of the proceeds should be allocated to the debt instrument portion of the transaction. This usually results in a discount, which should be accounted for under ASC Topic 835 [Interest].

According to PwC's Guide to Financing Transactions, practice has developed to interpret this guidance on debt instruments issued with warrants as equally applicable to preferred shares issued with warrants. The Private Placement should therefore be accounted for in a similar manner, and, given that preferred shares are not contractual debt instruments, the discount should be accounted for as a dividend rather than as interest expense.

Conclusion: Allocate the $6,572,080 in aggregate proceeds to the Series 1 Shares and Series C Warrants on the basis of their relative fair values. Record the Series C Warrant proceeds in paid-in capital. Accrete the discount on the Series 1 Shares created by the allocation of proceeds to the Series C Warrants to redemption value over time as a dividend. As a result, the Company allocated $2,057,437 to the Series C Warrants. See the attached workbook.

ASC 815-15-25-1 An embedded derivative shall be separated from the host contract and accounted for as a derivative instrument pursuant to Subtopic 815-10 if and only if all of the following criteria are met:

a. The economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract.

b. The hybrid instrument is not remeasured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur.

c. A separate instrument with the same terms as the embedded derivative would, pursuant to Section 815-10-15, be a derivative instrument subject to the requirements of this Subtopic. (The initial net investment for the hybrid instrument shall not be considered to be the initial net investment for the embedded derivative.)

Conclusion: As more fully articulated to the SEC in the Company's May 23, 2018 response to SEC letter comment #7, to which the SEC had no follow-up comments, and given that the Series 1 Shares are not publicly traded, the Company concluded that the conversion option described in Section 3.1 of the Preferred Shares, Series 1 Rights,

Privileges, Restrictions and Conditions was clearly and closely related to the equity host and hence should not be bifurcated.

ASC 470-20-20 A beneficial conversion feature is defined as a nondetachable conversion feature that is in the money at the commitment date.

ASC 470-20-25-5 An embedded conversion feature present in a convertible instrument shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital.

ASC 470-20-30-5 The effective conversion price based on the proceeds received for or allocated to the convertible instrument shall be used to compute the intrinsic value, if any, of the embedded conversion option. Specifically, an issuer shall do all of the following:

a. First, allocate the proceeds received in a financing transaction that includes a convertible instrument to the convertible instrument and any other detachable instruments included in the exchange (such as detachable warrants) on a relative fair value basis.

b. Second, apply the guidance beginning in paragraph 470-20-25-4 to the amount allocated to the convertible instrument.

c. Third, calculate an effective conversion price and use that effective conversion price to measure the intrinsic value, if any, of the embedded conversion option.

Conclusion: The investors in the Series 1 Shares executed irrevocable subscriptions on December 20, 2013, on which day the underlying Kingsway common stock price closed at $3.80 per share. The effective conversion price following the guidance above is determined to be $2.60 per share. As a result, the Company measured a beneficial conversion feature of $1,970,413. See the attached workbook.

Subsequent Accounting for the beneficial conversion feature ("BCF"):

470-20-35-7
Any discount recognized by the allocation of proceeds to a beneficial conversion feature under paragraph 470-20-25-5 shall be accounted for as follows:
a. Instruments having a stated redemption date. If a convertible instrument has a stated redemption date (such as debt and mandatorily redeemable preferred stock), that discount shall be accreted from the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs. Example 7 (see paragraph 470-20-55-28) illustrates the application of this guidance.

Excerpt from EY FRD Debt/Equity: 3.5.2.2 Conversion pursuant to the original terms with a beneficial conversion feature
Upon conversion of an instrument with a beneficial conversion option, all unamortized discounts, including any original issue discounts and discounts from allocation of proceeds, at the conversion date should be recognized immediately as a deemed dividend and deducted from income available to common stockholders.

Conclusion: The Preferred Stock has a mandatory redemption date of April 1, 2021. Therefore in accordance with the guidance in 470-20-35-7, the discount on the preferred stock (including created by the BCF), should be amortized from the date of issuance to the stated redemption date. See the attached workbook. Further, upon the conversion of the 40,000 shares in 2017, any unamortized discount related to such shares should be fully amortized immediately prior to the conversion. See the attached workbook. Note that transaction costs were also allocated between the preferred stock and warrants on a relative fair value basis and are being amortized together with the discount created by the warrants and BCF.

With respect to the Company's call option described in Section 5.1 and the mandatory redemption described in Section 5.3 of the Preferred Shares, Series 1 Rights, Privileges, Restrictions and Conditions, the Company notes that in order

to determine if a derivative should be bifurcated, the feature needs to meet the definition of a derivative in the first place under ASC 815-10-15-83.

Conclusion: The call option and mandatory redemption feature each fails to meet the definition of a derivative. The contract does not permit net settlement of these features. Also, the Company's preferred stock is not publicly traded and therefore not readily convertible to cash. Therefore, the call option and the mandatory redemption feature lack the net settlement required to meet the definition of a derivative. The mandatory redemption value of the Series 1 Shares is $6,571,900, and the Company has been accruing contractual dividends since the Series 1 Shares were issued on February 3, 2014, so the only adjustment needed to accrete the carrying value of the Series 1 Shares to its redemption value is the amortization of the discounts created by the allocation to the Series C Warrants and the allocation to the beneficial conversion feature. See the attached workbook.

Exchange of Series C Warrants for Series B Warrants

Conclusion: Given that the terms of the Series B Warrants are identical to the terms of the Series C Warrants and that the Series B Warrants were recorded in paid-in capital at the time of their issuance, there is no effect on the Company's financial statements from the exchange of Series C Warrants into Series B Warrants.

Journal Entries

The Company would have recorded the following entry on February 3, 2014, the closing date of the transaction:

Dr Cash	$6,572,080	
	Cr Class A Preferred	$2,302,479
	Cr Additional paid in capital	$2,057,437
	Cr. Additional paid in capital – BCF	$1,970,413
	Cr Accrued transaction expenses	$71,412
	Cr Prepaid expense	$170,339

The Company would have recorded the following annual journal entries:

2014

Dr Class A Preferred dividends	$330,556	
Cr Class A Preferred		$330,556

2015

Dr Class A Preferred dividends	$414,959	
Cr Class A Preferred		$414,959

2016

Dr Class A Preferred dividends	$480,355	
Cr Class A Preferred		$480,355

2017

Dr Class A Preferred dividends	$934,562	
Cr Class A Preferred		$934,562

Dr Class A Preferred		$1,000,000
Cr Additional paid in capital		$1,000,000

2018

Dr Class A Preferred dividends	$545,745	
Cr Class A Preferred		$545,745

Summary of Accounting Differences

2017

	As Reported as of and for the Year Ended December 31, 2017	Restated as of and for the Year Ended December 31, 2017	Difference
Class A preferred stock	5,461	3,463	(1,998)
Shareholders' Equity	38,461	40,459	1,998
General expenses	6,348	6,315	(33)

2018

	Drafted as of and for the Year Ended December 31, 2018	Updated as of and for the Year Ended December 31, 2018	Difference
Class A preferred stock	5,494	4,009	(1,485)
Shareholders' Equity	13,964	15,449	1,485
General expenses	7,407	7,374	(33)

May 29, 2019