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CANAL INSURANCE COMPANY
MEMORANDUM

TO: Principals and Primary Underwriters

FROM: Joyce Dunn

DATE: December 27, 2007

RE: Lincoln General and Kingsway

Please see the article below found in the Insurance Journal. As many of you may already know, A M Best downgraded the financial strength rating of Lincoln General to B++ from A- and the issuer credit rating of Lincoln's parent company, Kingsway Financial Services, Inc. to 'bbb' from 'a-'. These ratings remain under review with negative implications. Standard and Poor's Rating Services joined A. M. Best in lowering the unsecured and long-term credit ratings for Kingsway to BB+ from BBB- and assigned a negative outlook.

Lincoln General is a significant writer of truck insurance and it is uncertain if these changes will impact the truck writings of Lincoln General and if they do, to what extent. Should there be opportunity for Canal to bring a solution to a situation where a shipper or insured is uncomfortable with this rating change, please let us know.

We wanted to be sure you were aware of this change should any of your producing agents have questions. If you need further information, please let me know.

S&P Lowers Kingsway Ratings to 'BB+'; Outlook Negative

December 20, 2007

Standard & Poor's Ratings Services joined A.M. Best in lowering its senior unsecured and long-term counterparty credit ratings on Toronto-based Kingsway Financial Services Inc. to 'BB+' from 'BBB-'. S&P also lowered the debt ratings on Kingsway's subsidiaries to 'BB+' from 'BBB-' and assigned a negative outlook.

"The downgrade follows Kingsway's announcement that its lead U.S. operating company, Lincoln General Insurance Co. would be taking another unfavorable reserve adjustment for between US\$95 million and US\$125 million (all reserve adjustments quoted on a pretax basis)," said S&P.

"The negative outlook reflects the uncertainty that Kingsway has come to the end of its reserve adjustments, and also reflects the reduced level of financial flexibility that the company has given the decline in its net income," explained S&P credit analyst Donald Chu.

"The total increase in net estimates for unpaid claims occurring in prior periods for Lincoln General, including today's announcement, were US\$76 million in 2006 and US\$178 million-US\$208 million in 2007," S&P added. "These adjustments continue to be attributed primarily to the trucking and general liability lines of Lincoln General. Partially offsetting these unfavorable reserve developments were the US\$12 million and US\$35 million in reserve releases that were recognized elsewhere within the Kingsway group during 2006 and 2007."

S&P also warned that "while Kingsway has demonstrated the capacity to absorb these reserve adjustments for the most part without dipping into its consolidated capital, and has continued to maintain solid capital ratios, it is the ongoing reserve adjustments at Lincoln General and the lack of definitive proof that these issues are now behind the firm that raise continued concerns over the quality of governance, senior management oversight, and enterprise risk management (ERM) within its U.S. operations. This lingering uncertainty remains the primary rationale for the downgrade."

The rating agency acknowledged that "senior management is aware of these issues, and continues to take steps to address them. Following this rating action, notionally the ratings on the group's major operating companies would still be in the investment-grade category."

However, it explained the negative outlook as reflecting "the uncertainty around the level of Kingsway's reserves at Lincoln, and also reflects the company's reduced level of financial flexibility given the decline in its net income.

"If Kingsway is able to demonstrate stability around its reserves, earnings, and capital, we could revise the outlook to stable within the next 12 months. Further negative news could lead to a one notch downgrade. It remains our belief that Kingsway will continue to maintain its strong or leading market position in the nonstandard auto, trucking, and motorcycle insurance market; its conservative investment portfolio; and relatively strong capital adequacy ratios.

"As both the U.S. and Canadian markets continue to soften, premium growth will be challenged, as the company has indicated that it would be willing to give up market share to defend its operating margins.

"To restore the previous ratings, Kingsway will need to improve its ERM score from Standard & Poor's to adequate, from weak and improve the quality and consistency in its earnings. For the current rating, Standard & Poor's expects Kingsway to maintain a leverage ratio of less than 40 percent, a hybrid-to-total capital ratio of less than 15 percent, a fixed-charge coverage ratio of 4x or better, and a consolidated combined ratio of between 100 percent-102 percent. Double leverage should be maintained at less than 125 percent.

Source: Standard & Poor's - www.standardandpoors.com.

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