

# MAPSelect

## Appendix 1



**Waddell & Reed, Inc.**  
**SEC File Number: 16720**  
**Appendix 1 of Part 2A of Form ADV**

**MAPSelect**  
**The date of this Appendix is: March 30, 2012**

*This appendix provides information about the qualifications and business practices of Waddell & Reed, Inc. If you have any questions about the contents of this appendix, please contact us at (1-888-Waddell and/or [financialplanning@waddell.com](mailto:financialplanning@waddell.com)). The information in this appendix has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority*

Additional information about Waddell & Reed, Inc. is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Waddell & Reed, Inc. is a Federally registered Investment Advisor and a broker-dealer and member of FINRA.

*Note: Registration with the SEC as an Investment Advisor does not imply a certain level of skill or training.*

This appendix and the services and fees described in this appendix are all subject to change without prior notice to you.

Waddell & Reed, Inc.  
6300 Lamar Avenue  
Shawnee Mission, KS 66202

Contact Phone: 1-888-Waddell  
Contact Email: [financialplanning@waddell.com](mailto:financialplanning@waddell.com)

For more information about Waddell & Reed, Inc. please visit our website at [www.waddell.com](http://www.waddell.com)

If you invest in an advisory account through Waddell & Reed, Inc., your funds and securities will be held in a separate mutual fund account owned and controlled by you and/or in a separate brokerage account at Pershing LLC, a qualified custodian. Below are the addresses for Waddell & Reed Services Company, the transfer agent for the Waddell & Reed Advisors Funds and the Ivy Funds ("Transfer Agent"), and Pershing LLC:

Waddell & Reed Services Company  
6301 Glenwood  
Overland Park, KS 66202

Pershing LLC  
One Pershing Place  
Jersey City, NJ 07399

From time to time investors in our advisory accounts may receive reports directly from their Financial Advisors. These reports may include lists or summaries of your account holding, including funds and securities. We urge you to compare these reports to the official account statements of your account holdings provided at least quarterly by the Transfer Agent and/or Pershing LLC to ensure that the fund and securities holdings listed on these reports provided by your Financial Advisor match the fund and securities holdings reflected on the official account statements

## **Material Changes**

There have been no material changes since our last Form ADV Part II revision in March 2011.

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# Services, Fees and Compensation

## Introduction

Waddell & Reed, Inc. ("Waddell & Reed") is a securities broker-dealer and registered investment advisor serving clients nationwide. Waddell & Reed emphasizes comprehensive financial planning and provides a variety of personal financial services and investment opportunities. Through the financial planning process, Waddell & Reed Financial Advisors can help clients identify their unique financial goals and develop a plan to meet those goals. Waddell & Reed Financial Advisors have access to a broad array of investment and insurance products and services that can help satisfy their clients' planning needs.

Waddell & Reed sponsors an investment advisory program known as the Managed Allocation Portfolios Select ("MAP Select" or the "Program"). Only clients of Financial Advisors on Waddell & Reed's Choice platform are eligible to utilize the MAP Select advisory service. Waddell & Reed offers other investment advisory programs and services. However, only the Program is described in this appendix.

## Description of the Program

MAP Select is an asset allocation program that offers you a selection of strategic asset allocation models, a selection of mutual funds and exchange-traded funds ("ETFs"), as well as features such as systematic rebalancing and client participation in determining (within predetermined parameters) asset allocation across asset classes. The mutual funds available in the Program include proprietary mutual funds sponsored and/or managed by Waddell & Reed or its affiliates ("Waddell & Reed Mutual Funds") and non-proprietary mutual funds sponsored and/or managed by unaffiliated companies. The Program consists of five asset allocation models: Aggressive Growth, Growth, Conservative Growth, Income, and Conservative Income. Each model consists of eight asset classes, which are selected and assigned weightings within each model by Waddell & Reed. Mutual funds, including the Waddell & Reed Mutual Funds, and ETFs available in the Program are assigned to each asset class. Waddell & Reed has retained Lockwood Advisors, Inc. in independent registered investment advisor, to assist in identifying non-proprietary mutual funds and ETFs to include in the Program.

As part of the Program account opening process, you will complete a new account form and questionnaire both of which serve to identify each client's investment objectives, risk tolerance, and investment time horizon. You, after consultation with your Financial Advisor, will determine your appropriate investment profile and will select an asset allocation model, all based on your responses to the questionnaire. After an asset allocation model is selected, you and your advisor will review the mutual funds, including Waddell & Reed Mutual Funds, and ETFs available for each asset class in the model and you will select at least one mutual fund and/or ETF for each asset class in the chosen model. If you elect to participate in the Program you may, after consultation with your advisor, change the weighting of the asset classes in each model within certain predetermined parameters. This enables you to increase each model's risk and potential for return, thereby changing the balance of one or more of the selected asset class weightings in the selected model. The ultimate decision to participate in the Program, selection of the asset allocation model, selection of mutual funds and/or ETFs to be used in an asset allocation model and the decision to vary the asset class weighting within an asset allocation model is made by you, and is your absolute responsibility.

A cash balance of 2%-5% of account assets will be targeted for Program accounts. Automatic rebalancing will be performed when selected asset classes (as reflected in the values of holdings in that class within the model) deviate from the target allocation by more than 25% of the asset class value for qualified accounts and 30% of the asset class value for non-qualified accounts. Rebalancing may cause a taxable event.

All initial and subsequent investments into a Program account will be made from the Waddell & Reed Advisors Cash Management Fund (the "MAP Primary Fund"). The MAP Primary Fund is a money market mutual fund and may be replaced by Waddell & Reed in its sole discretion at any time. Assets invested in the MAP Primary Fund are subsequently used to purchase shares of mutual funds and ETFs selected by the client to populate their asset allocation model. Delays may occur between the receipt of the client's Program investment selections and the processing of the investment purchases, which may result in variances between the number of shares requested and the number of shares actually purchased. You may invest any amount in their Program account after your initial investment. You may also withdraw assets from your account, so long as your account value does not drop below the then current minimum required to remain in the Program. Additions to and withdrawals from a Program account will be made through the MAP Primary Fund and may cause a rebalancing to occur.

Waddell & Reed reviews the composition of the Program models periodically to determine whether models should be modified to better reflect Waddell & Reed's analysis of the economy and market conditions. These reviews may result in changes to the models, asset classes and mutual funds and ETFs within the asset classes. As Waddell & Reed moves one or more of the mutual funds and/or ETFs from one asset category to another you may need to select a new mutual fund or ETF to complete a model. You may find that the new mutual fund you select has higher internal expenses than the investment that was moved. You are encouraged to periodically reevaluate your asset allocation models and mutual fund selections to ensure they continue to be suitable and consistent with your evolving risk tolerance, investment objectives and time horizon. You should review the propriety of your asset allocation models with your advisor at least annually. Based upon these reviews, you are permitted and may decide to change your model allocation two times per year and your selected investments two times per year. There is no additional charge for this service.

The Program is available only to clients of advisors who utilize Waddell & Reed's Choice platform. The Program may be offered by the your advisor if your advisor believes that it is consistent with your stated risk tolerance and investment goals and objectives evidenced in Waddell & Reed's the risk tolerance questionnaire. In the event the information provided by you in Waddell & Reed's new account form or risk tolerance questionnaire becomes outdated or inaccurate, you should immediately notify your advisor and provide all information necessary to correct and/or update the new account form and/or risk tolerance questionnaire. Waddell & Reed reserves the right to determine which of its Financial Advisors are eligible to offer the Program. You will be required to sign an Advisory Services Agreement ("Services Agreement") if you elect to participate in the Program.

You must maintain at all times a minimum investment of \$50,000 in a Program account. In the event that an account falls below its minimum, Waddell & Reed may terminate the Services Agreement and convert the account to a standard brokerage account held at Pershing LLC. Mutual fund shares purchased through the Program are not subject to a sales load. They are generally Class A shares purchased at net asset value. Class A shares on which a load was originally paid may be invested in the Program only if the

transaction in which the shares were acquired occurred at least four years prior to the execution your Service Agreement.

## **Fees and Other Charges**

You will pay an ongoing asset-based advisory fee for your advisor's investment management services. The advisory fee is negotiable and is subject to discounts on an advisor-by-advisor and account-by-account basis, subject to minimum and maximum annual fee rates. The ranges of allowable annual fee rates are: between 0.75% and 1.90% on the first \$500,000 of Program account assets; between 0.70% and 1.85% on the next \$500,000 of Program account assets; and between 0.60% and 1.75% on Program account assets in excess of \$1,000,000. Fees are billed and collected quarterly in advance. Fees are computed on the market value of the account on the last day of the previous quarter. Fees will be automatically deducted from your Program account(s). If you terminates your Program account prior to a quarter's end, any unearned fee will be refunded on a pro-rata basis. Mutual funds in the Program generally pay an ongoing distribution and service (12b-1) fee to Waddell & Reed. This 12b-1 fee will be paid from the date the mutual fund shares are purchased. Fees assessed in connection with the Program are in addition to portfolio management and other fees and expenses charged by mutual funds and ETFs owned in a Program account. A portion of the asset-based fees you pay for advisory services in connection with the Program will be paid to your advisor and a portion will be paid to Waddell & Reed.

## **Important Disclosures Regarding Wrap Fee Programs**

Certain services provided in connection with the Program are available to you outside the Program at no charge. Also, depending on your investment objective, you may find that the individual components of the Program are available to you outside the Program for more (or less) than you pay to participate in the Program. You should discuss all of your investment options with your advisor before choosing to invest in the Program. Several factors may affect whether the Program costs are more or less than the costs of a traditional brokerage account, including trading strategy, types of securities purchased, whether the investments carry additional administrative or management fees, volume of trading, total expenses associated with trading the investments selected and the actual costs of the services utilized if purchased separately. Cash positions, including money market funds and sweep accounts, are subject to the Program fee. You should take this into account when selecting an appropriate investment objective.

## **Custody of Program Accounts**

Assets managed in Program accounts will be custodied in brokerage accounts held by Pershing LLC. Waddell & Reed has entered into a fully-disclosed clearing agreement with Pershing, LLC pursuant to which Pershing LLC has agreed to custody the brokerage account assets of Waddell & Reed's clients and to execute certain securities transactions on behalf of those clients. Pershing LLC will act as the sole custodian for all assets in Program accounts. Pershing LLC will perform all custodial functions customarily performed for brokerage accounts, including but not limited to crediting of interest and dividends. You will retain ownership of all cash and securities in the Program accounts, which will be reflected on the books and records of Waddell & Reed. If you have other brokerage accounts at Pershing, any fees charged for maintenance of those accounts will be separate from and in addition to fees charged for Program accounts. You must consider before electing to participate in the Program that, by using Pershing LLC as the custodian of your Program assets, you may pay higher account-related fees and execution charges,

and may not always receive as favorable executions as investors who participate in fee-based asset management products similar to the Program but who have the ability to select the broker-dealer or other platform to custody their assets and execute their transactions.

## **Principal Transactions and Agency Cross Transactions**

Advisors currently may not execute principal or agency cross transactions for Program accounts.

## **Execution of Transactions**

Transactions in Program accounts will be executed exclusively through Waddell & Reed's clearing broker-dealer, Pershing, LLC. Waddell & Reed regularly monitors Pershing's execution quality. We believe Pershing provides highly competitive execution quality based on (i) speed and certainty of execution; (ii) price and size improvement; and (iii) overall execution quality.

## **Trade Errors**

Waddell & Reed has a trade error procedure to resolve trading errors that may occur in Program accounts. Corrections are reviewed and approved by appropriate operations personnel. Corrections will be processed in a timely manner and will not adversely affect a client in a material way. Waddell & Reed maintains an error account to facilitate handling trade errors. Gains may be offset by losses in the error account.

## **Valuation**

Waddell & Reed relies primarily on third party quotation services, including services provided by Pershing LLC to determine the value of securities in Program accounts. If a price is unavailable or believed to be unreliable, we may determine the value in good faith. If the your portfolio strategy includes mutual funds, shares of Waddell & Reed Mutual Funds will be valued at their respective net asset values on the valuation date calculated in accordance with the respective Mutual Fund's prospectus. Shares of other mutual funds will be valued at their net asset values on the valuation date as provided by pricing sources that Waddell & Reed believes to be reliable. This pricing information may not be accurate, complete or provided in a timely manner. If the net asset value for a particular mutual fund's shares is not available for the valuation date, the most recent available net asset value will be used.

## **Benchmark Selection**

Due to the non-discretionary nature of the Program, performance reviews with your Financial Advisor may illustrate the performance of your Program account using the historical performance of certain broad equity and fixed income market indexes that are readily recognized but which may not be absolutely correlated with the make up of the Program account. Clients may designate an index they believe provides a more direct comparison to the performance of their Program account. Depending on the composition of a Program account and your chosen portfolio strategy, these broad indexes may not be an appropriate measure for comparison purposes. Therefore, you must understand that such comparisons are provided for illustration only. As a result, the performance of a particular portfolio strategy may vary significantly from the chosen index.

## Termination

The Program Service Agreement may be terminated at any time by the client upon written notice to Waddell & Reed as provided in the Service Agreement and upon thirty days prior written notice by Waddell & Reed. If you terminate the Service Agreement within five business days from the date they execute the Service Agreement, you will pay no fees or penalties. Thereafter, if you terminate the agreement, you will receive a pro rated refund of your asset-based fee. Upon termination Waddell & Reed will, unless otherwise instructed by you, move the securities holdings in your Program account into a traditional brokerage account until you provide instructions to either liquidate the securities, hold the securities in a brokerage account at Pershing LLC or transfer the securities to another broker-dealer or custodian. This process may have adverse tax consequences for taxable accounts.

## Amendment of Program

Waddell & Reed may change, modify or terminate the Program at any time in its sole discretion.

## Account Requirements and Types of Clients

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### Account Requirements

Please read carefully “Services, Fees and Compensation” above for a detailed discussion of account minimums.

### Client Types

Waddell & Reed typically provides investment advice to the following clients:

- Individuals
- Certain pension and professional plans
- Trusts, estates and charitable organizations
- Certain corporations and business entities not included in the categories above

## Portfolio Manager Selection and Evaluation

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### Advisory Services Generally

Waddell & Reed offers various types of investment advisory services, including:

- Financial Planning
- Asset Allocation Programs
- Wrap Fee Programs

We attempt to tailor each of our investment advisory services to your individual personal, financial and investment needs. We do this by requiring you to complete a risk tolerance questionnaire form that captures your personal financial information, risk tolerance and investment objectives, among other things.

The Program provides limited ability for you to impose reasonable restrictions on investing in certain securities or types of securities because you select the mutual funds and EFTs for your program account.

## Performance-Based Fees and Side-By-Side Management

Waddell & Reed does not charge performance-based fees or engage in side-by-side investment management.

## Methods of Analysis, Investment Strategies and Risk of Loss

Waddell & Reed typically recommends a broad asset allocation strategy across a number of diverse asset classes. For MAPSelect these asset classes are represented in the model portfolios of the various asset allocation models discussed in “Services, Fees and Compensation” above.

Asset allocation is one style of investing that may assist you in determining if you have an appropriate mix of investments for your personal investment needs. Development of a personalized asset allocation is designed to position your assets in accordance with your financial objectives, time horizon and risk tolerance.

The Program discussed in this appendix is based primarily on an investment concept known as Modern Portfolio Theory. This theory suggests that through diversification you may be able to minimize the effects of investment risk because investment gains in one asset class may offset losses in another. Of course, there is no certainty that any investment strategy will be profitable or successful in achieving your personal investment objectives. Your investment principal (unless you are invested all in cash or cash-like investments) will fluctuate with the financial markets. Therefore, your investments may be worth more or less than you originally paid for them at the time you decide to sell or redeem. And remember that asset allocation will not ensure a profit or protect against loss in a declining market.

If you have a substantial amount of your net worth concentrated in one or a small number of investment products or asset classes, the asset allocation process we use may prompt your Financial Advisor to recommend that you sell those investments and asset classes. It is always important to consult your tax and legal advisors before making significant changes to your investments because these changes may cause you to incur adverse tax consequences. Neither Waddell & Reed nor your Financial Advisor can provide the specialized, detailed legal and tax advice necessary to ensure that you avoid adverse tax consequences in these situations.

The Program enables clients to assume much greater risk by selecting from a broad array of mutual funds and EFTs and by selecting and pursuing higher risk investment strategies. You have freedom to choose the securities in which you invest within the guidelines imposed by the program structure.

We do not believe that the Program described in this appendix involves significant or unusual risks. However, the Program, depending on the securities you select, may present a significant risk of loss. For example, the EFTs or funds you select may present significant or unusual risks of loss.

## Voting Client Securities

Waddell & Reed does not accept authority to vote client securities proxies



## Client Information Provided to Portfolio Managers

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Each participant in the Program does so through their Waddell & Reed Financial Advisor. Your Financial Advisor is not the Program portfolio manager, because the Program is not managed on a discretionary basis. You and your Financial Advisor jointly make all investment decisions and product selections from the list of eligible securities. Please refer to “Services, Fees and Compensation”, “Description of the Program” above. You are encouraged to contact your Financial Advisor anytime you have a material change in your financial situation, investment objectives and/or risk tolerance.

## Client Contact with Portfolio Managers

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Waddell & Reed places no restrictions on your ability to contact and consult with your Financial Advisor. You are encouraged to contact your Financial Advisor regularly and anytime you experience material changes in your financial situation, investment objectives and/or risk tolerance.

## Additional Information

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### Disciplinary Information

On April 13, 2000, a letter of Acceptance, Waiver and Consent (No. C11000007) was approved by NASD Regulation, Inc. (“NASD”) relating to conduct of three (3) of Waddell & Reed’s Financial Advisors with respect to their misuse of account transaction request forms. The NASD found Waddell & Reed failed to establish, maintain and enforce written supervisory procedures reasonably designed to achieve compliance with the applicable securities laws and regulations and with applicable NASD rules relating, among other things, to forgery, unauthorized transactions and misappropriation. The NASD also found Waddell & Reed failed to respond adequately, and take appropriate action, to supervise its registered representatives, when confronted with evidence of problems in the above-referenced areas, that was reasonably designed to prevent the violations by the registered representatives.

On April 29, 2005, Waddell & Reed entered into a Decision & Order of Offer of Settlement with the NASD Department of Enforcement (“DOE”) settling a regulatory action brought by the DOE on January 14, 2004 (Case No. CAF040002) alleging that Waddell & Reed violated NASD Conduct Rules 2110, 2310, 3010 and 3110, and § 17(a)(1) of the Securities Exchange Act of 1934 and Rule 17a-3(A)(6) hereunder, relating to exchanges made by certain of its clients of their variable annuity policies. The DOE alleged that Waddell & Reed failed to take adequate steps to determine whether there were reasonable grounds for the clients to enter into the exchanges, such as determining whether the clients were likely to benefit or lose money from the exchanges, failed to establish sufficient guidance for the sales force to use in determining the suitability of the exchanges, failed to establish and maintain supervisory procedures or a system to supervise the activities of its advisors that was reasonably designed to achieve compliance with the requirements of the NASD’s suitability rule, and failed to maintain books and records regarding orders for unexecuted variable annuity exchanges. Without admitting or denying the allegations, Waddell & Reed agreed to be censured, pay a fine of \$5 million and pay client restitution of \$11 million. Waddell & Reed also entered into a global settlement with state regulators in connection with the NASD settlement. Without admitting or denying the state’s allegations, Waddell & Reed agreed to pay \$2 million fine and additional client restitution.

On July 24, 2006, Waddell & Reed entered into settlements with the U.S. Securities and Exchange Commission (“SEC”), the Attorney General of the State of New York (“NYAG”) and the Kansas Securities Commissioner (“KSC”) resolving their investigations into alleged market timing activities of shareholders of certain mutual funds for which Waddell & Reed serves as principal underwriter and distributor (the “Funds”). Based upon its investigation, the SEC alleged that a subsidiary of Waddell & Reed, Waddell & Reed Investment Management Company (“WRIMCO”), violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the “Advisers Act”) by following certain Fund Shareholders to engage in frequent trading of Fund shares in exchange for fees paid to Waddell & Reed and another Waddell & Reed subsidiary, Waddell & Reed Services Company (“WRSCO”), and that WRIMCO allowed such trading in the Waddell & Reed Advisors International Growth Fund (the “International Fund”) despite having been notified that the shareholders were harming the International Fund through dilution and failed to disclose the conflict of interest to the Funds’ Board of Directors and shareholders. The SEC also alleged that Waddell & Reed and WRSCO aided and abetted and caused WRIMCO’s alleged violations of Sections 206(1) and 206(2) of the Advisers Act by negotiating agreements with the shareholders allowing their trading of the Funds within certain defined limits and receiving financial benefit therefrom, and that WRIMCO, Waddell & Reed and WRSCO violated Section 17(d) of the Investment Company Act of 1940 (the “40 Act”) and Rule 17d-1 thereunder by participating in and effecting transactions in connection with joint arrangements in which the Funds were participants without filing an application with or receiving approval from the SEC. The NYAG alleged that Waddell & Reed’s conduct violated the Martin Act, Article 23-A of the General Business Law, § 349 of the General Business Law and § 63(12) of the Executive Law of the State of New York, and the KSC alleged that the conduct of Waddell & Reed, WRIMCO and/or WRSCO violated K.S.A 17-1253(a), 17-1253(b), 17-1254(m)(7), K.A.R. 81-3-1(i)(1) and/or 81-14-5(a). Without admitting or denying the alleged violations, Waddell & Reed agreed with the SEC, together with WRIMCO and WRSCO, to a censure, to cease and desist from violating Sections 206(1) and 206(2) of the Advisers Act, Section 17(d) of the 40 Act and Rule 17d-1 thereunder, to pay to the SEC \$40 million in disgorgement and a \$10 million civil penalty that will be distributed to Fund shareholders, and to implement certain compliance undertakings. Waddell & Reed also agreed with the NYAG to reduce the investment management fees on certain of the Funds by \$5 million per year for five years and to certain Fund governance undertakings, and Waddell & Reed, WRIMCO and WRSCO agreed with the KSC to pay a fine of \$2 million to be used for the education of consumers in matters concerning securities regulation and investments.



## Other Financial Industry Activities and Affiliations

Waddell & Reed is dually registered as a broker-dealer and Federally registered investment advisor. Your Financial Advisor may also offer to sell you on a commission basis either direct at the sponsor, including the Waddell & Reed Mutual Funds, or in brokerage accounts held at Pershing LLC one or more of the individual securities listed below:

- Equities and EFTs
- Certain Municipal Securities
- Certain Commercial Paper
- Certain Corporate Debt Securities
- Certain Brokered CDs
- Variable Life Insurance
- Variable Annuities
- Mutual Fund Shares
- U.S. Government and Certain Agency Securities
- Options on Securities

Waddell & Reed has material relationships and arrangements that are material to the investment advisory programs discussed in this appendix with the following:

**Pershing LLC** - Waddell & Reed clears its brokerage business exclusively through Pershing LLC on a fully disclosed basis. Clients that establish brokerage accounts with Waddell & Reed must establish those accounts at Pershing LLC. Clients will be subject to the various account and transaction related costs and fees assessed by Pershing LLC, which may be higher than those charged by other broker-dealers for similar services. Also, Waddell & Reed receives a share of certain charges imposed by Pershing LLC on the brokerage accounts they carry for us.

**Waddell & Reed Mutual Funds: Certain conflicts of interest may exist between you and Waddell & Reed and its affiliates if you purchase certain products or services recommended by your Financial Advisor, including the following:**

- Generally, Waddell & Reed and its affiliates will receive more overall compensation when you purchase Waddell & Reed Mutual Funds than when you purchase other mutual funds.
- Your Financial Advisor may receive concentrated training and information on products sponsored by affiliates of Waddell & Reed that may cause them to recommend Waddell & Reed Mutual Funds rather than other mutual funds.

Also, the investment managers for the Waddell & Reed Mutual Funds are wholly owned subsidiaries of Waddell & Reed.

**Lockwood Advisors, Inc.:** Lockwood Advisors, Inc. is an affiliate of Pershing LLC. Waddell & Reed uses Lockwood Advisors, Inc. as a platform for several of the fee-based asset allocation and wrap programs we offer as an investment advisor. Waddell & Reed pays various fees to Lockwood Advisors, Inc. for its services. Waddell & Reed also offers its clients SMA and UMA programs sponsored and/or managed by Lockwood Advisors, Inc. Waddell & Reed receives a portion of the fees you pay to participate in these programs.

## Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

Waddell & Reed has adopted a Code of Ethics. The Code of Ethics is primarily intended to establish specific standards of business conduct and to avoid any actual or potential conflict of interest or any abuse of the positions of trust and responsibility of certain persons considered "Access Persons".

Under the Code of Ethics, Access Persons are, among other things, required to report certain personal securities transactions and holdings, must pre-clear certain securities transactions, are restricted with respect to the timing of certain securities transactions, and are prohibited from making certain investments, all as more specifically provided in the Code of Ethics.

Waddell & Reed, its affiliates and their employees, directors and associated persons are prohibited from misusing, for their personal benefit or for the benefit of other, material nonpublic information.

Persons who violate any portion of the Code of Ethics, including the prohibitions against the misuse of nonpublic information, are subject to sanction, up to and including termination.

Our Financial Advisors may purchase or sell the same general securities (i.e. EFTs) they recommend to you. We review transactions in these securities on an ongoing basis to determine whether our clients receive the best execution. We have guidelines in our Code of Ethics to ensure that you receive the most favorable price in these situations.

Waddell & Reed will provide a copy of its Code of Ethics to any client or prospective client upon written request. Copies of the Code of Ethics may be obtained by writing to:

Waddell & Reed, Inc.  
Legal Department  
Attention: Code of Ethics  
6300 Lamar Avenue  
Shawnee Mission, KS 66202

## Review of Accounts

Waddell & Reed's supervisory structure includes division offices (sales offices) and regional offices (with supervisory responsibility over multiple division offices). Each division office has a Managing Principal, who is responsible for the day-to-day management of all Financial Advisors assigned to his or her division office, unless this responsibility is delegated to another principal. Each regional office has a Regional Vice President, who is responsible for the general management and oversight of all division offices assigned to his or her region.

Your accounts are reviewed and examined periodically at various supervisory levels of Waddell & Reed. Supervisory Principals in Waddell & Reed's home office determine the suitability of each investment advisory program discussed in this appendix. These home office Supervisory Principals conduct frequent reviews of client accounts for conformity with company policy and procedures.

You receive regular quarterly reports with respect to your Waddell & Reed Mutual Funds investments, quarterly and other reports with respect to the fee-based investment advisory products purchased through Waddell & Reed, and quarterly and other reports from the issuers of certain products you hold. If you maintain a Waddell & Reed brokerage account at Pershing LLC, you will receive quarterly or more frequent account statements and other account reports from Pershing LLC.

## **Client Referrals and Other Compensation**

The fees and other compensation earned by Waddell & Reed and your Financial Advisor differ depending on the advice and products that you select. Waddell & Reed and its affiliates receive more revenue from the sale of some financial products and services, particularly the Waddell & Reed Mutual Funds, than from the sale of other products and services. It is more profitable for Waddell & Reed and its affiliates if you purchase the Waddell & Reed Mutual Funds. Employees of Waddell & Reed and its affiliates may indirectly receive higher compensation and other benefits when your purchase these products. In addition, certain products, such as insurance, may pay more total compensation than other products. Waddell & Reed generally also receives more total revenue when the Waddell & Reed Mutual Funds are used inside the asset allocation and Wrap fee programs we sponsor.

Employee compensation (including management and field leader compensation) and operating goals at all levels of Waddell & Reed are tied to varying degrees to Waddell & Reed's overall financial success. As such, management, sales leaders and other employees generally spend more of their time and resources promoting Waddell & Reed affiliated products and services, including the Waddell & Reed Mutual Funds.

Both Waddell & Reed and your Financial Advisor are compensated when you buy mutual funds in the Program. Please refer to "Services, Fees and Compensation" and "Fees and Other Charges" above for more information.

Financial Advisors may also charge a fee to prepare a written financial plan from which they may make an investment recommendation. The investment recommendation may be implemented through any financial services firm and need not be implemented through Waddell & Reed. Should you choose to implement the recommendations through Waddell & Reed and its affiliates, you will incur costs in addition to the fees you will pay for your financial plan. Depending on the products or investment advisory services you decide to purchase through Waddell & Reed and its affiliates, you may pay more or less than if you purchased similar products and investment advisory services through other financial services firms.

Neither Waddell & Reed nor your Financial Advisor compensate anyone directly or indirectly for client referrals.

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**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Balance Sheet

December 31, 2011

(With Report of Independent Registered Public Accounting Firm Thereon)



KPMG LLP  
Suite 1000  
1000 Walnut Street  
Kansas City, MO 64106-2162

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors  
Waddell & Reed, Inc.:

We have audited the accompanying consolidated balance sheet of Waddell & Reed, Inc. and subsidiaries (the Company), a wholly owned subsidiary of Waddell & Reed Financial, Inc., as of December 31, 2011. This consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit of a balance sheet also includes examining, on a test basis, evidence supporting the amounts and disclosures in that balance sheet, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall balance sheet presentation. We believe that our audit of the balance sheet provides a reasonable basis for our opinion.

In our opinion, the consolidated balance sheet referred to above presents fairly, in all material respects, the financial position of Waddell & Reed, Inc. and subsidiaries as of December 31, 2011, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

Kansas City, Missouri  
February 28, 2012

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Balance Sheet

December 31, 2011

(In thousands)

**Assets**

Cash and cash equivalents	\$ 197,213
Cash and cash equivalents – restricted	50,556
Investment securities	49,917
Receivables:	
Funds and separate accounts	27,442
Customers and other	106,292
Due from affiliates	14,423
Deferred income taxes	11,096
Prepaid expenses and other current assets	8,166
Income taxes receivable	9,252
	<hr/>
Total current assets	474,357
Property and equipment, net	70,085
Deferred sales commissions, net	38,474
Deferred income taxes	15,530
Goodwill and identifiable intangible assets	35,095
Other assets	5,873
	<hr/>
Total assets	\$ <u><u>639,414</u></u>

**Liabilities and Stockholder's Equity**

Accounts payable	\$ 47,943
Payable to investment companies for securities	104,304
Accrued compensation	27,123
Payable to third party brokers	11,204
Other current liabilities	26,874
	<hr/>
Total current liabilities	217,448
Accrued pension and postretirement costs	45,958
Other noncurrent liabilities	20,552
	<hr/>
Total liabilities	283,958
	<hr/>
Commitments and contingencies	
Stockholder's equity:	
Common stock, \$1.00 par value. Authorized, issued, and outstanding 1,000 shares	1
Additional paid-in capital	214,454
Retained earnings	179,359
Accumulated other comprehensive loss	(38,358)
	<hr/>
Total stockholder's equity	355,456
	<hr/>
Total liabilities and stockholder's equity	\$ <u><u>639,414</u></u>

See accompanying notes to consolidated balance sheet.



**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

**(1) Summary of Significant Accounting Policies**

**(a) Organization**

Waddell & Reed, Inc. (W&R Inc.), a broker-dealer, and subsidiaries (the Company, we, our, and us) derive revenues primarily from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors Funds (the Advisors Funds), Ivy Funds Variable Insurance Portfolios (the Ivy Funds VIP), Ivy Funds, which are underwritten by an affiliate, and Ivy Funds InvestEd (InvestEd) (collectively, the Funds), and institutional and separately managed accounts. The Funds and the institutional and separately managed accounts operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the SEC). Services to the Funds are provided under investment management agreements, underwriting agreements, and shareholder servicing and accounting agreements that set forth the fees to be charged for these services. The majority of these agreements are subject to annual review and approval by each Fund's board of trustees and shareholders. Our revenues are largely dependent on the total value and composition of assets under management. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations. The Company is an indirect wholly owned subsidiary of Waddell & Reed Financial, Inc. (WDR), a publicly traded company. Consolidated financial statements of WDR are available.

The Company's underwriting agreements with the Funds allow the Company the exclusive right to distribute redeemable shares of the Funds on a continuous basis. The Company has entered into a limited number of selling agreements authorizing third parties to offer certain of the Funds. In addition, the Company also receives Rule 12b-1 asset-based service and distribution fees from certain of the Funds for purposes of advertising and marketing the shares of such funds and for providing shareholder-related services. The Company must pay certain costs associated with underwriting and distributing the Funds, including commissions and other compensation paid to financial advisors, sales force management, and other marketing personnel, compensation paid to other broker-dealers, plus overhead expenses relating to field offices, sales programs, and the costs of developing and producing sales literature and printing of prospectuses, which may be either partially or fully reimbursed by certain of the Funds. The Funds are sold in various classes that are structured in ways that conform to industry standards (i.e., front-end load, back-end load, level-load, and institutional).

The Company operates its investment advisory business and its transfer agency and accounting services business through its primary subsidiaries, Waddell & Reed Investment Management Company and Waddell & Reed Services Company, respectively.

**(b) Basis of Presentation and Consolidation**

The accompanying consolidated balance sheet is prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The accompanying consolidated balance sheet includes the accounts of the Company and its subsidiaries, all of which are wholly owned. Intercompany transactions and balances are eliminated in consolidation. The Company has

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Balance Sheet

December 31, 2011

evaluated subsequent events through February 28, 2012, the date that this financial statement was issued and determined there are no other items to disclose.

**(c) *Use of Estimates***

GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities in the consolidated balance sheet and accompanying notes, and related disclosures of commitments and contingencies. Estimates are used for, but are not limited to, depreciation and amortization, income taxes, valuation of assets, pension and postretirement obligations, and contingencies. Actual results could differ from those estimates.

**(d) *Cash and Cash Equivalents***

Cash and cash equivalents include cash on hand and short-term investments. We consider all highly liquid investments with original or remaining maturities of 90 days or less at the date of purchase to be cash equivalents. Cash and cash equivalents-restricted represents cash held for the benefit of customers segregated in compliance with federal and other regulations.

**(e) *Disclosures about Fair Value of Financial Instruments***

The fair value of cash and cash equivalents, receivables, and payables approximates carrying value. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values are based on quoted market prices of comparable instruments.

**(f) *Investment Securities***

Our investment securities are comprised of United States, state and government obligations, corporate debt securities, and investments in affiliated mutual funds. Investment securities are classified as available-for-sale or trading. W&R Inc. investment securities are classified as trading. The subsidiaries of W&R Inc. hold only available-for-sale securities. Unrealized holding gains and losses on securities available for sale, net of related tax effects, are excluded from earnings until realized and are reported as a separate component of comprehensive income. For trading securities, unrealized holding gains and losses are included in earnings. Realized gains and losses are computed using the specific identification method for investment securities, other than mutual funds. For mutual funds, realized gains and losses are computed using the average cost method.

Our available-for-sale investments are reviewed each quarter and adjusted for other than temporary declines in value. We consider factors affecting the issuer and the industry the issuer operates in, general market trends including interest rates, and our ability and intent to hold an investment until it has recovered. Consideration is given to the length of time an investment's market value has been below carrying value and prospects for recovery to carrying value. When a decline in the fair value of equity securities is determined to be other than temporary, the unrealized loss recorded net of tax in other comprehensive income is realized as a charge to net income and a new cost basis is established for financial reporting purposes. When a decline in the fair value of debt securities is determined to be other than temporary, the amount of the impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current period credit loss. If so, the

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Balance Sheet

December 31, 2011

other-than-temporary impairment recognized in earnings is equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If not, the portion of the impairment related to the credit loss is recognized in earnings while the portion of the impairment related to other factors is recognized in other comprehensive income, net of tax.

**(g) *Property and Equipment***

Property and equipment are carried at cost. The costs of improvements that extend the life of a fixed asset are capitalized, while the costs of repairs and maintenance are expensed as incurred. Depreciation and amortization are calculated and recorded using the straight-line method over the estimated useful life of the related asset (or lease term if shorter), generally three to 10 years for furniture, fixtures, and computer software; five to 10 years for data processing equipment; 10 to 30 years for buildings; three to 26 years for equipment; and up to 15 years for leasehold improvements, which is the lesser of the lease term or expected life.

**(h) *Software Developed for Internal Use***

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with *Intangibles – Goodwill and Other Topic*, Accounting Standards Codification (ASC) 350. Internal costs capitalized are included in "Property and equipment, net" on the consolidated balance sheet, and were \$10.6 million as of December 31, 2011. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally five to 10 years.

**(i) *Goodwill and Identifiable Intangible Assets***

Goodwill represents the excess of the cost of the Company's investment in the net assets of acquired companies over the fair value of the underlying identifiable net assets at the dates of acquisition. Goodwill is not amortized, but is reviewed annually for impairment in the second quarter of each year and when events or circumstances occur that indicate that goodwill might be impaired. Factors that the Company considers important in determining whether an impairment of goodwill or intangible assets might exist include significant continued underperformance compared to peers, the likelihood of termination or nonrenewal of a mutual fund management advisory contract or substantial changes in revenues earned from such contract, significant changes in our business and products, material and ongoing negative industry or economic trends, or other factors specific to each asset being evaluated.

The Company has one reporting unit for goodwill, investment management and related services. This unit's goodwill was recorded as part of the spin-off of WDR from its former parent, and to a lesser extent, was recorded as part of subsequent business combinations that were merged into the existing investment management operations.

To determine fair value of the reporting unit, our review process uses the market and income approaches. In performing the analyses, the Company uses the best information available under the circumstances, including reasonable and supportable assumptions and projections.

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Balance Sheet

December 31, 2011

The market approach employs market multiples for comparable companies in the financial services industry. Estimates of fair values of the reporting units are established using multiples of earnings before interest, taxes, depreciation and amortization (EBITDA). The Company believes that fair values calculated based on multiples of EBITDA are an accurate estimation of fair value.

If the fair value coverage margin calculated under the market approach is not considered significant, the Company utilizes a second approach, the income approach, to estimate fair values and averages the results under both methodologies. The income approach employs a discounted free cash flow approach that takes into account current actual results, projected future results, and the Company's estimated weighted average cost of capital.

The Company compares the fair values of the reporting units to their carrying amounts, including goodwill. If the carrying amount of the reporting unit exceeds its implied fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any.

Indefinite-life intangible assets represent a mutual fund management advisory contract for managed assets obtained in an acquisition. The Company considers this contract to be an indefinite-life intangible asset as it is expected to be renewed without significant cost or modification of terms. The Company also tests this asset for impairment annually by comparing its fair value to the carrying amount of the asset.

**(j) *Deferred Sales Commissions***

The Company defers certain costs, principally sales commissions and related compensation, that are paid to financial advisors and broker/dealers in connection with the sale of certain mutual fund shares sold without a front-end load sales charge. The costs incurred at the time of the sale of Class B shares are amortized on a straight-line basis over five years, which approximates the expected life of the shareholders' investments. The costs incurred at the time of the sale of Class C shares are amortized on a straight-line basis over 12 months. In addition, the costs incurred at the time of the sale of shares for certain asset allocation products are deferred and amortized on a straight-line basis, not to exceed three years. The Company recovers such costs through Rule 12b-1 and other distribution fees, which are paid on Class B and Class C shares of the Advisor Funds, along with contingent deferred sales charges (CDSC's) paid by shareholders who redeem their shares prior to completion of the required holding period (three years for shares of certain asset allocation products, six years for a Class B share and 12 months for a Class C share). Should the Company lose the ability to recover such sales commissions through distribution fees or CDSC's, the value of these assets would immediately decline, as would future cash flows. The Company periodically reviews the recoverability of the deferred sales commission assets as events or changes in circumstances indicate that the carrying amount may not be recoverable and adjust them accordingly.

**(k) *Revenue Recognition***

We recognize investment management fees as earned over the period in which services are rendered. We charge the Advisors Funds and Ivy Funds VIP daily based upon average daily net assets under management in accordance with investment management agreements between the Advisors Funds

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Balance Sheet

December 31, 2011

and Ivy Funds VIP and the Company. In general, the majority of investment management fees earned from institutional and separate accounts are charged quarterly based upon an average of net assets under management at the end of the months within the quarter in accordance with such agreements.

Underwriting and distribution revenues resulting from the sale of investment products are recognized on the trade date.

Fee-based asset allocation revenues are charged quarterly based upon average daily net assets under management.

We also recognize distribution revenues monthly on certain types of investment products, primarily variable annuity products, which are generally calculated based upon average daily net assets under management.

The Company collects Rule 12b-1 service and distribution fees under the distribution and service plan agreements with the Advisors Funds and Ivy Funds VIP. Rule 12b-1 service and distribution fees are collected for costs related to the distribution and servicing of mutual fund shares such as sales commissions paid to other broker-dealers, advertising, sales brochures, and costs for providing ongoing services to mutual fund shareholders. The plan allows for payment to the Company of 25 basis points of average daily net assets under management on an annual basis for Class A shares and 100 basis points for Class B and C shares. The Company must engage in activities that are intended to result in the sale of mutual fund shares.

Shareholder service fees are recognized monthly and are calculated based on the number of accounts or assets under management as applicable. Other administrative service fee revenues are recognized as contractual obligations are fulfilled or as services are provided.

Revenue sharing is recognized monthly. Through a revenue sharing allocation agreement with affiliates, the Company receives 25 basis points on gross sales of assets and 10 basis points on average assets under management for Ivy Funds sold through the proprietary channel. In addition, the Company receives revenue for providing accounting, legal, marketing, rent, and other administrative services to affiliated companies.

**(l) *Income Taxes***

The Company files consolidated federal income tax returns with WDR. The Company's provision for income taxes has been made on the same basis as if the Company filed separate federal income tax returns using the maximum statutory rate applicable to the consolidated group. The Company is included in the combined state returns filed by WDR and also files separate state income tax returns in other state jurisdictions in which the Company operates that do not allow or require the affiliated group to file on a combined basis.

Income tax expense is based on pre-tax financial accounting income, including adjustments made for the recognition or derecognition related to uncertain tax positions. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

prescribed by *Income Taxes Topic*, ASC 740. Deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. A valuation allowance is recognized for deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the asset will not be realized. Deferred tax assets and deferred tax liabilities are measured using enacted tax rates expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in earnings in the period that includes the enactment date.

The Company recognizes tax benefits from equity awards in WDR stock granted to its employees. These tax benefits are reflected as an increase to additional paid-in capital with a corresponding increase to income taxes receivable.

**(2) Investment Securities**

Investments at December 31, 2011 are as follows (in thousands):

	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Fair value</u>
Available-for-sale securities:				
Mortgage-backed securities	\$ 9	2	—	11
Municipal bonds	2,549	—	(13)	2,536
Corporate bonds	11,743	96	(5)	11,834
Affiliated mutual funds	15,006	1,343	(899)	15,450
Total available-for-sale securities	\$ 29,307	1,441	(917)	29,831
Trading securities:				
Mortgage-backed securities				63
Municipal bonds				500
Corporate bonds				12,239
Common stock				37
Affiliated mutual funds				7,247
Total trading securities				20,086
Total investment securities				\$ 49,917

(Continued)



**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

A summary of available-for-sale securities with fair values below carrying values at December 31, 2011 is as follows (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Municipal bonds	\$ —	—	2,536	13	2,536	13
Corporate bonds	3,647	5	—	—	3,647	5
Affiliated mutual funds	9,697	899	—	—	9,697	899
Total temporarily impaired securities	\$ 13,344	904	2,536	13	15,880	917

Based upon our assessment of these municipal bonds, corporate bonds and affiliated mutual funds, the time frame investments have been in a loss position, our intent to hold such securities until they have recovered, and our history of holding bonds until maturity, we determined that a write-down was not necessary at December 31, 2011.

Mortgage-backed securities, municipal bonds, and corporate bonds accounted for as available for sale as of December 31, 2011 mature as follows (in thousands):

	Amortized cost	Fair value
After one year but within ten years	\$ 13,300	13,392
After ten years	1,001	989
	\$ 14,301	14,381

Mortgage-backed securities, municipal bonds, and corporate bonds accounted for as trading and held as of December 31, 2011 mature as follows (in thousands):

	Fair value
After one year but within ten years	\$ 12,739
After ten years	63
	\$ 12,802

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

Accounting standards establish a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of the asset. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset. An individual investment's fair value measurement is assigned a level based upon the observability of the inputs which are significant to the overall valuation. The three-tier hierarchy of inputs is summarized as follows:

- Level 1 – Investments are valued using quoted prices in active markets for identical securities at the reporting date.
- Level 2 – Investments are valued using other significant observable inputs, including quoted prices in active markets for similar securities.
- Level 3 – Investments are valued using significant unobservable inputs, including the Company's own assumptions in determining the fair value of investments.

Assets classified as Level 2 can have a variety of observable inputs, including, but not limited to, benchmark yields, reported trades, broker quotes, benchmark securities, and bid/offer quotations. These observable inputs are collected and utilized, primarily by an independent pricing service, in different evaluated pricing approaches depending upon the specific asset to determine a value. Securities' values classified as Level 3 are primarily determined through the use of a single quote (or multiple quotes) from dealers in the securities using proprietary valuation models. These quotes involve significant unobservable inputs, and thus the related securities are classified as Level 3 securities.

The following table summarizes our investment securities as of December 31, 2011 that are recognized in our consolidated balance sheet using fair value measurements based on the differing levels of inputs (in thousands):

		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Mortgage-backed securities	\$	—	74	—	74
Municipal bonds		—	3,036	—	3,036
Corporate bonds		—	24,073	—	24,073
Common stock		37	—	—	37
Affiliated mutual funds		22,697	—	—	22,697
Total	\$	<u>22,734</u>	<u>27,183</u>	<u>—</u>	<u>49,917</u>

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

**(3) Goodwill and Identifiable Intangible Assets**

Goodwill represents the excess of purchase price over the tangible assets and identifiable intangible assets of acquired business. Our goodwill is not deductible for tax purposes. Goodwill and identifiable intangible asset (all considered indefinite lived) at December 31, 2011 are as follows (in thousands):

Goodwill	\$ 16,514
Accumulated amortization	<u>(8,272)</u>
Total goodwill	8,242
Total identifiable intangible asset	<u>26,853</u>
Total	<u><u>\$ 35,095</u></u>

In 2011, the Company's annual impairment test indicated that goodwill and identifiable intangible asset were not impaired. Related to goodwill, the fair value of the investment management and related services reporting unit exceeded its carrying value by more than 100% and the fair value of our indefinite-life intangible asset exceeded its carrying value by more than 100%.

**(4) Property and Equipment**

A summary of property and equipment at December 31, 2011 is as follows (in thousands):

		<u>Estimated useful lives</u>
Furniture and fixtures	\$ 29,679	3 – 10 years
Data processing equipment	19,255	5 – 10 years
Computer software	68,060	3 – 10 years
Equipment	18,380	3 – 26 years
Leasehold improvements	19,255	1 – 15 years
Building	3,765	10 – 30 years
Land	<u>1,940</u>	
Property and equipment, at cost	160,334	
Accumulated depreciation	<u>(90,249)</u>	
Property and equipment, net	<u><u>\$ 70,085</u></u>	

At December 31, 2011, we have property and equipment under capital lease with a cost of \$1.7 million and accumulated depreciation of \$0.9 million.

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

**(5) Income Taxes**

The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2011 is presented as follows (in thousands):

Deferred tax liabilities:	
Deferred sales commissions	\$ (172)
Property and equipment	(11,998)
Benefit plans	(9,554)
Purchase of fund assets	(5,590)
Prepaid expenses	(1,960)
	<hr/>
Total gross deferred liabilities	(29,274)
Deferred tax assets:	
Capital loss carryforward	3,022
Additional pension and postretirement liability	22,695
Unrealized losses on investment securities	304
Accrued expenses	12,550
Nonvested stock	16,772
State net operating loss carryforwards	4,084
Federal benefit on state liabilities	2,062
Unused state tax credits	1,120
Other	525
	<hr/>
Total gross deferred assets	63,134
Valuation allowance	(7,234)
	<hr/>
Net deferred tax asset	\$ 26,626

During 2009, the Company sold a subsidiary, which generated a capital loss available to offset potential future capital gains. Due to the character of the loss and the limited carryforward period permitted by law, the Company may not realize the full tax benefit of the capital loss. The capital loss carryforward, if not utilized, will expire in 2014. The deferred tax asset, net of federal tax effect, relating to the capital losses as of December 31, 2011 is approximately \$3.0 million. As of December 31, 2011, other net deferred tax assets, which are capital in nature, are approximately \$0.3 million. Management believes it is not more likely than not that the Company will generate sufficient future capital gains to realize the full benefit of these capital losses, and accordingly, a valuation allowance in the amount of \$3.3 million has been recorded at December 31, 2011. During 2011, declines in the Company's investment portfolio resulted in an increase of \$0.3 million in the valuation allowance against deferred tax assets that are capital in nature. The decline in the investment portfolios was partially offset by realized capital gains in 2011, which allowed for the release of \$0.3 million of the valuation allowance as a reduction to tax expense. The remaining \$0.6 million increase in the valuation allowance was recorded as an increase in accumulated other comprehensive loss.

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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December 31, 2011

As of December 31, 2011, the Company has net operating loss carryforwards in certain states in which the Company files on a separate company basis and has recognized a deferred tax asset for such loss carryforwards. The deferred tax asset, net of federal tax effect, related to the carryforwards is approximately \$4.1 million at December 31, 2011. The carryforwards, if not utilized, will expire between 2012 and 2031. Management believes it is not more likely than not that the Company will generate sufficient future taxable income in certain states to realize the benefit of the net operating loss carryforwards, and accordingly, a valuation allowance in the amount of \$3.9 million has been recorded at December 31, 2011. The Company has state tax credits of \$1.1 million as of December 31, 2011 that can be utilized in future tax years. Of these state tax credit carryforwards, \$0.8 million will expire between 2019 and 2021 if not utilized and \$0.3 million will expire in 2027 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration dates.

As of January 1, 2011, the Company had unrecognized tax benefits, including penalties and interest, of \$6.1 million (\$4.3 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. As of December 31, 2011, the Company had unrecognized tax benefits, including penalties and interest, of \$7.3 million (\$5.3 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying consolidated balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes receivable.

The Company's historical accounting policy with respect to interest and penalties related to tax uncertainties has been to classify these amounts as income taxes. As of January 1, 2011, the total amount of accrued interest and penalties related to uncertain tax positions included in the consolidated balance sheet was \$1.9 million (\$1.5 million net of federal benefit). The total amount of penalties and interest, net of federal benefit, related to tax uncertainties recognized in the consolidated statement of earnings for the year ended December 31, 2011 was \$0.2 million. The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2011 of \$2.1 million (\$1.7 million net of federal benefit) is included in the total unrecognized tax benefits described above.

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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December 31, 2011

The following table summarizes the Company's reconciliation of unrecognized tax benefits (excluding penalties and interest) for the year ended December 31, 2011 (in thousands):

	<b>Unrecognized tax benefits</b>
Balance at January 1, 2011	\$ 4,138
Increases during the year:	
Gross increases – tax positions in prior period	1,092
Gross increases – current period tax positions	860
Decreases during the year:	
Gross decreases – tax positions in prior period	(256)
Decreases due to lapse of statute of limitations	(615)
Balance at December 31, 2011	<u>\$ 5,219</u>

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. During 2011, the Company did not settle any open tax years that were undergoing audits by state jurisdictions in which the Company operates. The Company received notification of a favorable outcome on a tax position, which the Company had previously considered partially uncertain and, therefore, had not previously recognized the full tax benefit. The 2008, 2009, and 2010 federal income tax returns are the only open tax years that remain subject to potential future audit. The 2005, 2006, and 2007 federal tax years also remain open to a limited extent due to capital loss carryback claims. State income tax returns for all years after 2007 and, in certain states, income tax returns prior to 2008, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

The Company is currently being audited in various state jurisdictions. It is reasonably possible that the Company will settle the audits in these jurisdictions within the next 12-month period. It is estimated that the Company's liability for unrecognized tax benefits could decrease by approximately \$0.2 million to \$1.8 million (\$0.1 million to \$1.2 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on reported income.

**(6) Pension Plan and Postretirement Benefits Other Than Pension**

The Company participates in the WDR sponsored noncontributory retirement plan (the Plan) that covers substantially all employees. Benefits payable under the Plan are based on an employee's years of service and compensation during the final 10 years of employment. WDR allocates pension expense to the Company for the Plan. Such costs for 2011 were \$6.9 million.

(Continued)



**WADDELL & REED, INC. AND SUBSIDIARIES**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2011

The total projected benefit obligation of the Plan is \$148.4 million, of which \$127.5 million relates to the Company. The total pension benefits liability (representing the projected benefit obligation in excess of the pension plan assets) recorded on the consolidated balance sheet of WDR at December 31, 2011 is \$45.0 million, of which \$38.6 million relates to the Company.

The Company also participates in the WDR sponsored unfunded defined benefit postretirement medical plan (medical plan) that covers substantially all employees including Waddell & Reed advisors. The medical plan is contributory with retiree contributions adjusted annually. All contributions to the medical plan are voluntary as it is not funded and is not subject to any minimum regulatory funding requirements. The contributions for each year represent claims paid for medical expenses. Net accrued medical plan costs in the amount of \$8.1 million are recorded on the consolidated balance sheet of WDR at December 31, 2011, of which \$7.6 million relates to the Company. Of the Company's total liability at December 31, 2011, \$0.3 million is included in other current liabilities, while the remainder is long term in nature. During 2011, WDR allocated \$0.9 million of expense to the Company for the medical plan.

**(7) Employee Savings Plan**

The Company participates in the WDR sponsored defined contribution plan that qualifies under Section 401(k) of the Internal Revenue Code to provide retirement benefits for employees following the completion of an eligibility period. As allowed under Section 401(k), the plan provides tax-deferred salary deductions for eligible employees. The Company's matching contributions to the plan for the year ended December 31, 2011 were \$3.7 million.

**(8) Net Capital Requirements**

The Company is subject to the SEC Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15.0 to 1.0. A broker/dealer may elect to not be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of Rule 15c3-1, in which case net capital must exceed the greater of \$250 thousand or 2% of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for broker/dealers. Our Company made this election and is not subject to the aggregate indebtedness ratio as of December 31, 2011. At December 31, 2011, the Company had net capital of \$34.5 million that was \$34.3 million in excess of its required net capital of \$250 thousand. The primary difference between net capital and stockholder's equity are the nonallowable assets that are excluded from net capital.

**(9) Rule 15c3-3 Exemption**

The Company does not hold customer funds or safekeep customer securities and is therefore exempt from Rule 15c3-3 of the SEC under subsection (k)(2)(i) and (k)(2)(ii). The Company did not have any customers' fully paid securities and excess margin securities that were not in the Company's possession or control as of December 31, 2011 for which instructions to reduce to possession or control had been issued as of December 31, 2011, but for which the required action was not taken by the Company within the time frames specified under Rule 15c3-3 of the Securities Exchange Act of 1934. The Company also did not have any customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of December 31, 2011, excluding items arising from

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“temporary lags that result from normal business operations” as permitted under Rule 15c3-3 of the Securities Exchange Act of 1934. Under this exemption, the “Computation for Determination of Reserve Requirements” and “Information Relating to the Possession or Control Requirements” are not required.

**(10) Share-Based Compensation**

WDR allocates expenses for nonvested shares of WDR stock to the Company that, in turn, are granted to certain key personnel of the Company under its stock incentive plans. Nonvested stock awards are valued on the date of grant, have no purchase price and vest over four years in 33⅓% increments on the second, third, and fourth anniversaries of the grant date. Under WDR’s stock plans, shares of nonvested stock may be forfeited upon the termination of employment with the Company, dependent upon the circumstances of termination. Except for restrictions placed on the transferability of nonvested stock, holders of nonvested stock have full stockholders’ rights during the term of restriction, including voting rights and the rights to receive cash dividends. The Company pays WDR for expense related to these awards.

**(11) Rental Expense and Lease Commitments**

The Company leases home office buildings, certain sales, and other office space and equipment under long-term operating leases. Future minimum rental commitments under noncancelable operating leases are as follows (in thousands):

2012	\$	19,091
2013		15,656
2014		11,498
2015		8,102
2016		5,413
Thereafter		27,317
	\$	<u>87,077</u>

New leases are expected to be executed as existing leases expire. Thus, future minimum lease commitments are not expected to be materially different than those in 2011.

**(12) Transactions with Related Parties**

The current amounts due from affiliates at December 31, 2011 includes noninterest-bearing advances for current operating expenses and commissions due from the sales of affiliates’ products. The current amounts due to affiliates at December 31, 2011 include amounts due for administrative and other services.

The amount classified as income tax receivable at December 31, 2011 consists entirely of amounts due from WDR for tax allocations.

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Notes to Consolidated Balance Sheet

December 31, 2011

**(13) Contingencies**

The Company is involved from time to time in various legal proceedings, regulatory investigations and claims incident to the normal conduct of business, which may include proceedings that are specific to us and others generally applicable to business practices within the industries in which we operate. A substantial legal liability or a significant regulatory action against us could have an adverse effect on our business, financial condition and on the results of operations in a particular quarter or year.

*Michael E. Taylor, Kenneth B. Young, individuals, on behalf of themselves individually and on behalf of others similarly situated v. Waddell & Reed, Inc., a Delaware Corporation; and DOES 1 through 10 inclusive*; Case No. 09-CV-2909 DMS WVG; in the United States District Court for the Southern District of California.

In this action filed December 28, 2009, the Company was sued in an individual action, class action and Fair Labor Standards Act (FLSA) nationwide collective action by two former advisors asserting misclassification of financial advisors as independent contractors instead of employees. Plaintiffs, on behalf of themselves and a purported class of W&R Inc. financial advisors, assert claims under the FLSA for minimum wages and overtime wages, and under California Labor Code Statutes for timely payment of wages, minimum wages, overtime compensation, meal periods, reimbursement of losses and business expenses and itemized wage statements and a claim for Unfair Business Practices under §17200 of the California Business & Professions Code. Plaintiffs seek declaratory and injunctive relief and monetary damages.

Plaintiffs moved for conditional collective action certification under the FLSA. The Company opposed this motion and additionally moved for summary judgment on Plaintiffs' individual FLSA claims. The Court issued an order on January 3, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual FLSA claims fail as a matter of law, and denying Plaintiffs' motion for conditional collective action certification under the FLSA as moot. This ruling effectively removes all nationwide FLSA claims from the case.

Plaintiffs intend to continue to pursue the California claims and may seek to amend their complaint to attempt to revive certain FLSA claims. An adverse determination in this matter could have a material adverse impact on the financial position and results of operations of the Company. The Company intends to continue to vigorously defend plaintiffs' claims.

At this stage in this litigation, based upon the information currently available to the Company, the Company is not able to determine that an unfavorable outcome is remote, reasonably possible, or probable, and the Company has determined that it cannot reasonably estimate either the amount or the range of possible losses that would result if plaintiffs were to prevail, therefore, the Company has not made any accruals with respect to this matter in its consolidated balance sheet.

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