

# Advisory Services

**SPA**  
STRATEGIC PORTFOLIO ALLOCATION

**MAP**  
MANAGED ALLOCATION PORTFOLIOS

*from Waddell & Reed*

**Waddell & Reed, Inc.**  
**SEC File Number: 16720**  
**Part 2A of Form ADV: Firm Brochure**  
**Asset Allocation and Wrap Products Only Brochure**  
**The date of this Brochure is: May 1, 2013**

*This brochure provides information about the qualifications and business practices of Waddell & Reed, Inc. If you have any questions about the contents of this brochure, please contact us at (1-888-Waddell and/or [financialplanning@waddell.com](mailto:financialplanning@waddell.com)). The information in this brochure 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 brochure and the services and fees described in this brochure are all subject to change without prior notice to you.

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

Disclosure Required by SEC Rule 206(4)-2:

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 at Waddell & Reed Services Company, the transfer agent for the Waddell & Reed Advisors Funds and the Ivy Funds ("Transfer Agent") at the address below:

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

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 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.

## Summary of Material Changes

# Advisory Services

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## Advisory Business

The following discussion presents an overview of Waddell & Reed, Inc. and discusses generally the Financial Planning and related products and services we offer and our corporate structure. This section contains certain defined terms that will be used throughout the Brochure:

### Overview and Ownership

Waddell & Reed, Inc. (Waddell & Reed) is a securities broker-dealer and a Federally registered investment advisor serving clients nationwide. Waddell & Reed was founded in 1937 and emphasizes comprehensive financial planning and provides a variety of personal financial services and investment opportunities. Through the financial planning process, Financial Advisors can help clients identify their unique financial goals and develop a plan to meet those goals. And, 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 is a wholly owned subsidiary of Waddell & Reed Financial, Inc., a publicly held company (NYSE: WDR). Waddell & Reed provides highly competitive mutual fund offerings, including the Waddell & Reed Advisors Funds, the Ivy Funds, the Ivy Funds VIP offered within variable insurance products provided by our strategic insurance partners (currently Minnesota Life Insurance Company and Nationwide Life Insurance Companies (collectively the "Strategic Partners")) and the Waddell & Reed InvestEd Portfolios offered within Waddell & Reed's 529 Plan (collectively the "Waddell & Reed Mutual Funds").

As part of an organization that manages and offers the Waddell & Reed Mutual Funds, Financial Advisors have direct access to portfolio managers and other professionals who are involved in analyzing and managing the Waddell & Reed Mutual Funds on an ongoing basis. Therefore, Financial Advisors have the opportunity to know the Waddell & Reed Mutual Funds well. Waddell & Reed believes this close alignment between our Financial Advisors and mutual fund managers is of enormous benefit to the firm's Financial Advisors and, more importantly, to our clients.

Of course, as needed or desired, Financial Advisors can offer Mutual Funds and other products that are not proprietary to Waddell & Reed. They may do so when the Waddell & Reed Mutual Funds may not satisfy your goals fully or it may be in your best interests to consider other investment options consistent with your personal and financial goals. More often than not, though, Financial Advisors will recommend Waddell & Reed Mutual Funds. For nearly 70 years, Waddell & Reed and its affiliates have consistently been recognized for their commitment to investment excellence. Waddell & Reed investment philosophy has always been and continues to be today:

#### **Focus on growing and protecting investors' assets:**

a sound approach that seeks to capture asset appreciation when market conditions are favorable, and strives to manage risk consistent with the objectives of the Waddell & Reed Mutual Funds.

**Rigorous fundamental research:** an enduring investment culture that dedicates itself to analyzing companies on its own rather than relying solely on outside research and trends.

## Advisory Services Generally

This brochure gives you information about the costs and benefits of our mutual fund asset allocation programs that we call SPA and the MAP programs. SPA and the MAP programs will be discussed in much greater detail later in this brochure.

We are dedicated to high-quality service for the duration of our relationship, which may span a lifetime of financial decision-making. Therefore, you should communicate to your Financial Advisor immediately if and when your personal situation changes. It is important that you inform your Financial Advisor of these changes, as recommendations made based upon outdated information may no longer be appropriate. Please note that it is not always possible to work with the same Financial Advisor over an extended period of time. Under certain circumstances, your Financial Advisor may decide to retire or leave Waddell & Reed. In this event, we will assign a new Financial Advisor to assist you with future needs.

Waddell & Reed cannot promise or guarantee that your financial objectives will be realized through implementation of our recommendations. The rate of return for most investments cannot be predicted. Your Financial Advisor does not monitor the day-to-day performance of specific investments recommended through the financial planning process. Your Financial Advisor will not provide discretionary money management (that is, implement the decision on his or her own). Nevertheless, Waddell & Reed will periodically rebalance, and/or reallocate your account without your prior direction. If you purchase mutual funds or insurance products through Waddell & Reed or its Strategic Partners, you will receive quarterly statements from the issuers of those products.

Neither your Financial Advisor nor Waddell & Reed is acting as a fiduciary within the meaning of the Employee Retirement Income Security Act of 1974 ("ERISA") or the Internal Revenue Code of 1986, including with respect to asset allocation services provided you. Neither your Financial Advisor nor Waddell & Reed are providing investment advice for a fee that is intended as the primary basis for your investment decisions in Tax Sheltered Accounts, (e.g., TSA or 403(b) plans) 457 plans or ERISA covered plans (e.g., 401(k) plan). Also, to the extent an asset allocation service identifies any specific investment alternative, please note that other investment alternatives having similar risk and return characteristics may be available to you. In applying an asset allocation model to your situation, you should also consider your other assets, income and other investments not held at Waddell & Reed (e.g., equity in a home, savings accounts, brokerage accounts and interests in other qualified and non-qualified plans) as neither Waddell & Reed nor your Financial Advisor provides investment advice or investment advisory services with respect to these assets.

Information included in this brochure is incorporated into your Waddell & Reed Client Service Agreement, an agreement you must sign to participate in the programs discussed in this brochure.

**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.

Except as otherwise provided, your Financial Advisor does not have any discretionary authority over the decision to purchase or sell investment and insurance products. Your Financial Advisor must always give you the final authority to determine how your assets are invested and what investment and insurance products to purchase or sell. Your Financial Advisor is not permitted to provide advice to purchase or sell investment or insurance products that cannot be purchased by you through your Financial Advisor at Waddell & Reed. For example, your Financial Advisor cannot actively manage assets maintained in a 401(k) plan sponsored by your employer or in an account at another brokerage firm.

Your Financial Advisor cannot retain custody of any of your assets, including stock or bond certificates or cash. You should never make checks payable to your Financial Advisor or to any entity other than Waddell & Reed or the sponsor of the investment or insurance product you are purchasing.

## Mutual Fund Asset Allocation Programs

Waddell & Reed offers three basic mutual fund asset allocation programs to a certain group of clients that wish to hold their mutual funds direct at the mutual fund and invest only in the Waddell & Reed Mutual Funds. Clients should note that they have limited ability to impose investment restrictions on our mutual fund asset allocation programs. Clients may only select from the Waddell & Reed Mutual Funds available in the model portfolio in these programs. These programs are described in more detail below:

### Strategic Portfolio Allocation

Waddell & Reed currently offers an asset allocation advisory program known as Strategic Portfolio Allocation (SPA). Waddell & Reed's utilizes a variety of tools, including fundamental analysis to develop SPA asset allocation models for various market and economic conditions. Clients' assets are allocated between and among shares of Waddell & Reed Mutual Funds including domestic and international equity funds, money market and fixed income funds and total return funds.

SPA employs five (5) separate models, each designed for different investment objectives. The five (5) models are intended to reflect Conservative, Balanced, Growth, Appreciation and Aggressive strategies. The Conservative model will allocate investments more heavily in fixed income mutual funds. The Balanced model seeks a risk-adjusted market-based return. The Growth model is designed for investors with a higher tolerance for risk and will be more heavily allocated in equity funds, both domestic and international. The Appreciation and Aggressive models are designed to suit clients with greater risk tolerances and aggressive investment objectives. The Appreciation model allocates investments predominantly in domestic and international equity funds with a lesser allocation to domestic and international fixed income-type funds. The Aggressive model invests primarily in international and domestic equity securities including emerging markets and will not normally include any material allocation to debt securities.

SPA clients' investments are allocated in accordance with the model selected by the client. Prior to the initial allocation into the model selected by a SPA client, the client's initial and subsequent investments will be invested temporarily in Waddell & Reed Advisors Cash Management, a money market mutual fund, subject to change at the discretion of Waddell & Reed (collectively referred to as SPA Primary Fund). Investments in the SPA Primary Fund are then exchanged in accordance with a schedule established by

Waddell & Reed into Class A shares purchased at net asset value (NAV Shares) that are available in each model. Due to a variety of factors, there may be delays between the receipt of transaction requests from clients and the processing of such requests. Initial and subsequent purchases from the SPA Primary Fund are made in accordance with the percentage allocations of the model selected by the client in effect at the time of purchase. Partial redemptions from a SPA account are made from the mutual funds in the SPA account, as determined by Waddell & Reed, in its sole discretion, in a manner designed to make the post-redemption allocation of the SPA account more consistent with the allocations of the model selected by the client in effect at the time of the redemption, but there can be no assurance that the SPA account will be allocated in accordance with the applicable model's percentage allocations. All redemptions from SPA accounts will be made by exchanging shares of the mutual funds in the SPA account sufficient to accommodate the redemption request for shares of the SPA Primary Fund and funding the redemption request from the SPA Primary Fund. Waddell & Reed may establish minimum investment amounts, from time to time, in its discretion as a condition to participation in a SPA account. The minimum investment into a SPA account is currently \$25,000. Waddell & Reed, reserves the right to return SPA account investments to clients in the event the minimum investment amount is not received by Waddell & Reed within the time parameters established by Waddell & Reed in its discretion. Although empirical research supports the benefits of investment diversification through asset allocation, there can be no assurance that SPA will result in enhanced performance. It is possible for SPA accounts to decline in value, including a loss of the principal investment, and the advisory fees associated with SPA may negatively impact clients' investment returns.

The SPA models are reviewed periodically and may be altered based upon its analysis of financial, market and other data. Any alteration may result in higher fees paid to Waddell & Reed, and/or one or more of its affiliates or companies under common control.

Clients are cautioned that redeeming Waddell & Reed Mutual Funds or selling shares of other mutual funds, particularly Class A shares or Class B and C shares subject to a CDSC, to use the cash proceeds to purchase Waddell & Reed Mutual Funds at NAV in a SPA account may subject you to adverse tax consequences. Such redemptions may also be unsuitable. Waddell & Reed may terminate the SPA Service Agreement with clients who are determined to have engaged in such activity.

Exchanges between the mutual funds within a SPA account, and redemptions to pay advisory fees for SPA services, may constitute taxable events if done outside a tax-advantaged account or product and may result in tax liability and/or tax withholding. Prospective clients are encouraged to consult a tax advisor to determine the tax consequences of participation in SPA. Redemptions of mutual fund shares from SPA accounts may cause a client's allocations to deviate from the allocation of the model selected by the client. Dividend and capital gains distributions paid by the mutual funds in a SPA account are automatically reinvested to purchase additional shares of the distributing mutual fund and may not be paid to the client. Contingent Deferred Sales Charge (CDSC) will not be assessed on redemption of liable shares.

**Note: Anything herein to the contrary notwithstanding, Waddell & Reed may change, modify or terminate the SPA program at any time in its sole discretion.**



## Letter of Intent (LOI)

SPA accounts are eligible to be linked under a Letter of Intent (LOI) in order to reduce sales charges on Class A retail accounts. The value of the investor's SPA accounts, prior to the acceptance date of this Agreement, will be considered when determining the intended investment amount. In addition, purchases during the 13 month LOI period in a SPA account will be credited toward satisfying the LOI and should be considered when determining the face amount of the LOI. Investments in SPA products, prior to the establishment of the LOI and/or during the 13 month LOI period, will not require a sales charge adjustment since investments in SPA are at NAV. An LOI is not appropriate for an investor who only intends to invest in SPA products. It is disadvantageous to establish an LOI at the time a SPA account is established unless retail accounts (non-SPA) are also owned and additional investments will be added to the retail accounts. Please refer to the fund prospectus for additional information.

## Managed Allocation Portfolios

Waddell & Reed sponsors two mutual fund asset allocation programs that offer clients a selection of strategic asset allocation models, as well as features such as systematic rebalancing and client participation in determining (to a limited extent) asset allocation across asset classes. These asset allocation programs are MAP and MAPPlus (sometimes referred to collectively as the MAP Program or Programs). MAP and MAPPlus are discussed separately in more detail below, along with information common to both MAP Programs.

**Allocation Models and Asset Classes.** MAP and MAPPlus consist of five primary asset allocation models: Aggressive Growth, Growth, Conservative Growth, Income and Conservative Income. Each MAP Program model is constructed of up to eight asset classes, which are selected and assigned weightings within each model by Waddell & Reed. Waddell & Reed also assigns one or more of the Waddell & Reed Mutual Funds to each asset class within the model. In addition to the five models listed above, MAP has an additional Conservative Model.

**Account Opening.** Clients must complete a questionnaire that serves to identify each client's investment objectives, risk tolerance, and investment time horizon. The client, after consultation with their Financial Advisor, will determine their appropriate investment profile and will select an asset allocation model, all based on the client's responses to the questionnaire. After an asset allocation model is selected, the client and their advisor will review Waddell & Reed Mutual Funds available for each asset class in the model and the client will select at least one mutual fund for each asset class in the chosen model. The minimum investment at account opening is \$750 per fund in the portfolio. Clients that elect to participate in MAPPlus may, after consultation with their Financial Advisor, change the weighting of the asset classes in each model within certain pre-determined parameters using a proprietary tool designed by Waddell & Reed. This tool enables MAPPlus clients to increase each model's risk and potential for return by changing the balance of one or more of the selected asset class weightings in the selected model. The ultimate decision to participate in a MAP Program, selection of the asset allocation model, selection of Waddell & Reed Mutual Funds to be used in an asset allocation model and the decision by MAPPlus clients to vary the asset class weighting within an asset allocation model is made by, and is the ultimate responsibility of, the client.

**Rebalancing.** All MAP accounts currently have the option to select either annual or semi-annual rebalancing. For accounts that elect to change rebalancing frequency, the next rebalance will be based upon the last rebalance date. MAPPlus accounts are automatically

rebalanced quarterly, semi-annually, or annually. The rebalancing frequency of the MAP program accounts is selected by the client at the time they establish their MAP program account. Annual rebalancing is implemented at the end of a thirteen (13) month time period, and will take place on day 395 instead of day 365 of the yearly rebalancing. Automatic rebalancing will be performed only when selected asset class (as reflected in the values of mutual fund holdings in that class on the date the account is scheduled for rebalancing) deviates from the target allocation by more than 1% of the account value. Account rebalancing will be accomplished by buying and selling shares of mutual funds as necessary to reach the target allocations indicated in the MAP Services Agreement. Rebalancing may cause a taxable event. Therefore, clients should consult with their tax advisor before deciding to participate in a MAP Program.

**Funding a MAP Program account.** All initial and subsequent investments into a MAP 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 the Waddell & Reed Mutual Funds selected by the client. A delay of at least one day will occur between the receipt of the client's MAP Program mutual fund selection and the processing of the share purchases, which may result in variances between the number of shares requested and the number of shares actually purchased. However, in order to avoid a potential wash sale event we will transfer non-retirement funds in-kind from the non-MAP account to the new MAP account, which are non-reportable events. This process will initially cause funds to show up in the MAP account that are not part of the model; however, once the shares have transferred into the MAP account, the Funds will automatically rebalance on the following business day to the selected model. Clients may invest any amount in their MAP Program account after their initial investment. Clients may also withdraw assets from their account, so long as their account value does not drop below the then current minimum required to remain in the MAP Program they select. Additions to a MAP Program account will be made through the MAP Primary Fund in accordance with the then-current account allocation. Withdrawals from a MAP Program account will be made by sale of the underlying funds, then through the MAP Primary Fund in a manner that is intended to minimize variances from targeted allocations.

**Changes to Mutual Funds and Asset Allocation Models.** MAP Program model portfolios are strategic in nature and are based on long-term historical asset class assumptions and long-term forward looking projections. Therefore, it is not likely that there will be changes to the model portfolio's asset class percentages. However, Waddell & Reed periodically reviews the composition of the MAP Program models to determine whether the models should be modified to better reflect the economy and forecasted long-term market conditions. These reviews may result in changes to the models, asset classes, or mutual funds within the asset classes. To the extent Waddell & Reed moves one or more mutual funds from one asset category to another the client may need to select a new mutual fund to complete a model and may find that the new mutual fund they select has higher internal expenses than the mutual fund that was moved. It is important to consider that Waddell & Reed will populate the asset allocation models with only Waddell & Reed Mutual Funds. Waddell & Reed will not consider mutual funds created and managed by mutual fund companies other than Waddell & Reed or its affiliates, even though such other mutual funds may have lower internal expenses and better performance than similar Waddell & Reed Mutual Funds. Clients are encouraged to periodically reevaluate their asset allocation models to ensure that the selected model continues to be suitable and consistent with

the client's evolving risk tolerance, investment objectives and time horizon. MAP Program clients must review the propriety of their asset allocation models at least annually. MAP clients are permitted two model changes and two fund changes per 12-month period. A change to the Conservative model in MAP is not considered a model change and an additional change is permitted 12-months from the model change before the Conservative portfolio was selected. In addition, due to the conservative nature of this model and the large allocations to Money Market, it is possible that this model may experience losses after fees and expenses. Therefore, this model may not be appropriate for the long-term. MAPPlus clients are permitted two model changes and two fund changes per year. There is no additional charge for this service. Clients will be asked to complete a new risk tolerance questionnaire in order to effect model changes.

**Meetings and Reports.** All MAP Program clients must meet with their advisor at least annually to evaluate their ongoing participation in the MAP Programs. Clients are strongly encouraged to meet with their advisors more frequently if they have questions about their participation in the MAP Programs or if their personal or financial circumstances change. There is no additional charge for meetings or other communications to discuss the MAP Programs. Clients will receive periodic reports, statements, confirmations and updated summary prospectuses from the mutual funds they own in the MAP Programs. Clients should carefully read all such material. Waddell & Reed will send periodically additional informational reports on the MAP Programs, including information that describes the then current performance, holding, etc., of the mutual funds in the MAP Programs, overall investment performance and independent commentary on the mutual funds in each model. Clients should carefully read this material, as well as discuss any questions with their Financial Advisor.

**Account Minimums.** Clients must maintain at all times a minimum investment of \$15,000 in a MAP account and \$25,000 in a MAPPlus account. In the event that an account falls below its respective minimum, Waddell & Reed may terminate its agreement with the client and redeem all of the mutual fund holdings in the account. The redemption proceeds will be transferred to the client's MAP Primary Fund.

Nevertheless, clients may deposit less than the minimum investment (currently \$15,000 for MAP and \$25,000 for MAPPlus accounts) in the rare situation where the remaining cash to bring the total deposit up to the required minimum is anticipated to be received within 120 days or less. The MAP Program account will not be established until the cash in the Primary Fund reaches the account minimum. If this does not occur within 90 days of the initial cash deposit, the client will receive a communication from Waddell & Reed advising them that they have 30 days from the date of the notification to provide the remaining cash deposit and appropriate MAP Program account Client Service Agreement and other required account documentation. If the client fails to deposit the cash necessary to fund the MAP Program account and provide the necessary MAP Program account documentation within this additional 30 day notice period, the initial cash deposit will be returned to the client and the MAP Program account will not be established.

Mutual fund shares purchased through the MAP Programs are not subject to a sales load. They are class A shares purchased at net asset value (NAV). Class A shares on which a load was originally paid may be invested in the MAP Programs only if the transaction in which the shares were acquired occurred at least three years prior to the execution of the client's MAP Program Service Agreement.

The contingent fee described below will not apply to these shares.

**Letter of Intent (LOI).** MAP accounts are eligible to be linked under a Letter of Intent (LOI) in order to reduce sales charges on Class A retail accounts. The value of the investor's MAP accounts, prior to the acceptance date of this Agreement, will be considered when determining the intended investment amount. In addition, purchases during the 13 month LOI period in a MAP account will be credited toward satisfying the LOI and should be considered when determining the face amount of the LOI. Investments in MAP products, prior to the establishment of the LOI and/or during the 13 month LOI period, will not require a sales charge adjustment since investments in MAP are at NAV. An LOI is not appropriate for an investor who only intends to invest in MAP products. It is disadvantageous to establish an LOI at the time a MAP account is established unless retail accounts (non-MAP) are also owned and additional investments will be added to the retail accounts. Please refer to the fund prospectus for additional information.

**Financial Planning Services Available to MAP Program Clients.** Clients who elect to invest in a MAP Program account will be offered certain financial planning services at no additional charge. These services will be offered based on the value of assets invested and will be offered annually for the entire time the account remains open. Financial planning services will be offered in tiers based on the MAP Program account value, with more sophisticated services available to clients who invest more assets in the account. Initially, the eligibility level for financial planning services will be determined by adding together the initial MAP Program account assets and any additions anticipated within twelve months from the date of the MAP Program Service Agreement. The MAP Program account will be valued annually thereafter on the MAP Program Service Agreement anniversary. The level of financial planning services to which the client will be entitled will be based on the value of the account on the most recent MAP Program Service Agreement anniversary date. Assets from household accounts, if any, will be included in the account valuation. MAP Program accounts will be grouped into households for determining eligibility for financial planning services. Waddell & Reed will review each MAP Program account on the anniversary of the establishment of the oldest account for the household to determine the account value for purposes of determining which financial planning services will be offered during the succeeding year. Waddell & Reed may in its sole discretion add, substitute, and/or delete financial planning services from each MAP Program at anytime in its sole discretion. If a MAP Program account is closed, any open MAP Program Financial Planning Services Agreements will be terminated. If you have a MAP Program Financial Planning Services Agreement in place and your advisor retires, leaves Waddell & Reed or your MAP Program account is reassigned to another advisor for any reason, the MAP Program Financial Planning Services Agreements will be terminated. If additional planning services are desired, you must complete a new agreement with your new advisor. Currently, the financial planning services offered and the asset levels at which they are offered are as follows:



## **Household Asset Value**

\$50,000 to \$99,999

\$100,000 to \$249,999

Any of the Previously  
Listed Services, Plus:

\$250,000 to \$999,999

Any of the Previously  
Listed Services, Plus:

\$1,000,000 and Above

Any of the Previously  
Listed services or:

## **Planning Services**

FOCUSPlan Select Module  
FOCUSPlan Forecast  
FOCUSPlan Start-Up Plan  
FOCUSPlan  
Investment Planning Strategy  
(INVESTMENTPlan)

FOCUSPlan Tax Sensitive  
Wealth Forecasting Strategy

FOCUSPlan Tax Sensitive with  
Detailed Cash Flow  
Estate Planning Strategy  
Business Planning Strategy

FOCUSPlan Premier

**Note: Your Financial Advisor must provide and you must read carefully Waddell & Reed's Financial Planning Services Brochure before you select one or more of the financial planning services listed above.**

Clients may determine that they do not need to use every financial planning service available in any given year. However, unused services do not carry over into subsequent years and services available in one year may not be available in subsequent years if the account value falls below the threshold required for those services at the next MAP Account anniversary date. Conversely, if the account value rises above a threshold, the client will be offered those financial planning services available at the new asset threshold. Clients who paid Waddell & Reed before establishing a MAP Program account for any of the financial planning services offered here will not receive a refund of that fee merely by establishing a MAP Program account at a certain asset level. Therefore, it is likely that a client will pay their Financial Advisor both a fee for financial planning services and asset-based fees for a MAP Program. It is also possible that clients who establish a MAP Program account will not take advantage of any of the financial planning services available to them at no additional cost, but rather will pay their Financial Advisor additional fees to provide more sophisticated financial planning services than those services to which they may be entitled by virtue of establishing a MAP Program account. This is because the client's personal financial situation and goals may require more sophisticated financial planning services than the services available through the MAP Program account at no additional cost.

## **Partial Redemptions**

Partial redemptions from the MAP account are made from the mutual funds in the MAP account, in a manner designed to make the post-redemption MAP account more consistent with the allocations of the model selected by the client in effect at the time of the redemption.

## **Termination**

The MAP Service Agreement signed by the client may be terminated at any time by the client upon written notice to Waddell & Reed in accordance with the terms of the MAP Service Agreement. Waddell & Reed may terminate the MAP Service Agreement at any time upon thirty days prior written notice to the client. This may include a situation in which the client's MAP account falls below the then MAP account minimum. If the client or Waddell & Reed terminate the MAP Service Agreement, the client will pay any pro-rated unpaid asset-based fee and the applicable portion of the contingent fee.

The terminated MAP account will be closed in accordance with one of the scenarios described below:

**Terminations initiated by Waddell & Reed.** The mutual fund shares in the MAP account may be sold if the account value falls below the then applicable account minimum value. The client will receive a 30 day written notice of termination. If the client fails to provide written instructions for account disposition within the 30 day period, the account will be liquidated and the proceeds will be mailed to the address of record on the MAP account or to an intermediary of the client's choice.

**Terminations initiated by the Client.** Clients may terminate their MAP account any time voluntarily by providing written notice to Waddell & Reed. Clients that elect to voluntarily terminate their MAP account must elect one of the options discussed below:

1. Clients may instruct Waddell & Reed to redeem the W&R Advisor Funds and/or Ivy Mutual Funds held in their MAP account and transfer the cash proceeds to the address of record on the account being terminated or to an intermediary of the client's choice.
2. Clients may instruct Waddell & Reed to transfer Ivy Fund mutual fund shares in kind to an intermediary of the client's choice so long as the intermediary has an effective selling agreement with Ivy Funds at that time. It is the client's responsibility to ensure that the intermediary they select has an effective selling agreement. Waddell & Reed Advisor Funds are not eligible to be transferred to an intermediary. Therefore the shares will be redeemed and the proceeds forwarded to the intermediary.
3. Clients may redeem their Waddell & Reed Mutual Funds held in the MAP account and purchase Class A shares of the Waddell & Reed Mutual Funds in a Waddell & Reed non-Map mutual fund account held direct at the Fund at no additional cost.

**Note: Prospective clients must read carefully the following additional disclosures related to MAP accounts before investing:**

- Clients must consider before purchasing shares of the Waddell & Reed Advisors Funds mutual fund shares are proprietary and cannot be transferred in kind to another intermediary such as a broker-dealer. Clients that elect to purchase these mutual fund shares in their MAP account will be limited to option one (1) if they decide to terminate their MAP account and transfer the then market value of the Waddell & Reed advisors mutual fund shares to themselves or to another intermediary.
- Clients that redeem mutual fund shares in a taxable MAP account may incur adverse tax consequences. Clients are urged to consult their tax professional before redeeming mutual fund shares in a taxable MAP account.

**Note: Waddell & Reed may change, modify or terminate the MAP Programs, or either of them, at any time in its sole discretion.**

## **Important Information for MAP Program Clients:**

- **Affiliated Mutual Funds.** All of the mutual funds approved for use with the MAP Programs are Waddell & Reed Mutual Funds. It is not necessary to participate in the MAP Programs in order to purchase Waddell & Reed Mutual Funds. However, different costs and expenses will apply as set forth in each mutual fund's prospectus and statement of additional information.

- **Fund Performance.** There is no assurance that the mutual funds selected for use in the MAP Programs will perform in any particular manner. Past performance of a mutual fund or asset class is no guarantee of future performance. Clients must carefully read the prospectus of each mutual fund selected for the MAP Programs before investing.
- **Mutual Fund Fees and Expenses.** The asset-based fee described below does not cover the underlying fees and expense of the mutual funds selected for the MAP Programs, as specifically described in each mutual fund's prospectus. The mutual fund's fees and expenses will reduce a client's investment return. Each mutual fund's current fees and expenses may vary significantly in future years.
- **Other Asset Allocation Programs May Be Less Expensive.** Clients may be able to invest in similar asset allocation programs through other sponsors that have lower asset-based and other fees and expenses and provided better performance than the MAP Programs.
- **Conflicts.** The MAP Programs involve significant conflicts of interest. Clients must read carefully the sections of this brochure and the prospectus for each mutual fund that describe and discuss those conflicts before investing.
- **Qualification to Offer MAPPlus.** Not all Financial Advisors are qualified to offer MAPPlus. If a client believes MAPPlus is the most suitable program they must first inquire if their Financial Advisor can offer it. If not, they must either invest in MAP or ask their advisor to refer them to an advisor who can offer MAPPlus.
- **Dividends and Capital Gains.** Dividend and capital gain distributions paid by the Waddell & Reed Mutual Funds held in a MAP Program account will be automatically reinvested in additional mutual fund shares and will not be paid to clients.
- **Inappropriate Client Activity.** Clients are cautioned that redeeming Waddell & Reed Mutual Funds or selling shares of other mutual funds, particularly Class A shares on which a load was paid or Class B or C shares subject to a CDSC, to use the cash proceeds to purchase Waddell & Reed Mutual Funds at NAV in a MAP Program account may subject you to adverse tax consequences. Such redemptions may also be unsuitable. Waddell & Reed may terminate the MAP Program Service Agreement with clients who are determined to have engaged in such activity.

## Managed Allocation Portfolio Income

Waddell & Reed sponsors a Mutual Fund and Variable Annuity Asset Allocation Program that offers clients a selection of strategic asset allocation mutual fund models (MAPIA) coupled with a variable annuity with a guaranteed minimum withdrawal benefit (Nationwide Destination Architect). We refer to this unique investment program as Managed Allocation Portfolio Income (MAPIncome). The objective of MAPIncome is to enable clients, along with your Financial Advisor, to develop a personalized retirement income strategy that fits your specific needs, risk tolerance and investment objectives.

If you entered into your MAPIncome program prior to May 1, 2013, you own the Nationwide Income Architect annuity contract. If you have questions concerning this contract we would urge you to consult your advisor as well as the applicable ADV and prospectus in effect at the time you purchased MAPIncome. After May, 1 2013, the MAPIncome program including the Income Architect Annuity contract has been replaced with the Destination Architect annuity contract.

MAPIncome clients will invest a portion of their assets in strategic asset allocation mutual fund model portfolios structured substantially similar to our traditional MAP Program model portfolios. Many characteristics of a MAPIA account, including

account opening, rebalancing, fund changes and account termination, are discussed in detail in the section of this brochure titled "Managed Allocation Portfolios" regarding the MAP Program.

Clients should read carefully the detailed discussion of the MAP Program before deciding to invest in the MAPIA portion of MAPIncome. The MAP Program features and characteristics will remain the same for MAPIA clients, except as follows:

- **Minimum Initial Investment.** The Minimum Initial Investment for the MAPIA is variable but may not be less than \$25,000. Nevertheless, if the client invests more than \$50,000 in the overall MAPIA combined products, the minimum investment in the MAPIA account must be the greater of \$25,000 or 25% of the aggregate amount invested in MAPIncome combined products.
- **Account Minimum.** Clients must maintain at least \$25,000 in their MAPIA account. If a MAPIA account reaches \$5,000 from either market action or withdrawals or a combination of the two, the client will be advised to deposit sufficient funds to bring the MAPIA account back to \$25,000. Failure to make this deposit will automatically terminate your MAPIA investment, causing the termination of your MAPIncome program and the decoupling of the variable annuity portion of MAPIncome from the MAPIA account.
- **MAPIA Termination.** You or Waddell & Reed can terminate your MAPIA investment under the terms of your MAPIA Service Agreement.
- **Allocation Models.** The Asset Allocation Models available in MAPIA will be substantially similar to those currently available to clients that invest in MAP. The only difference is that the cash allocation portion of those portfolios will target 7% for MAPIA clients as opposed to 2% for MAP clients. For the Conservative Model, the additional 5% cash is taken from the additional Money Market Allocation. For the other five Model Portfolios, the additional 5% cash is taken from the Investment Grade Fixed Income Asset Class with the exception of the Growth and Aggressive Growth models, whereby the additional 5% cash is taken from a blend of assets. The additional cash retained in the MAPIA portfolios will be used to pay the asset-based fees assessed on the MAPIA and variable annuity portions of MAPIncome.

Clients will purchase a Nationwide Destination Architect (NDA) variable annuity provided by Nationwide Life Insurance Company (Nationwide) to compliment the MAPIA account and complete their MAPIncome program. The NDA has many features, including no initial load, a guaranteed minimum withdrawal benefit, death benefit and investment options. These features and other material aspects of the NDA are discussed in more detail below, as follows:

- **Minimum Investment.** The minimum investment permitted to purchase the NDA is \$25,000. Nevertheless, the percentage of the client's total investment in MAPIncome that is allocated to the NDA annuity will be determined by you and your Financial Advisor.
- **Purchase of NDA.** Investors in MAPIncome will be required to purchase the NDA annuity from Nationwide. The NDA is a no-load variable annuity. A no-load variable annuity has no initial sales charge. This means that you can exchange or redeem the NDA at anytime without paying a deferred sales charge. Nevertheless, variable annuities are not appropriate for all investors. Your Financial Advisor will ask you to complete various documents in connection with your NDA purchase that will help you, your advisor and Waddell & Reed determine whether the NDA is an appropriate investment for you.
- **MAPIA Termination.** As discussed above, clients must maintain at least \$25,000 invested in MAPIA at all times. Failure to do

somay cause the MAPIA investment to terminate. See the section titled "Account Minimum" above. Termination of your MAPIA investment can also occur if you exchange your NDA for another insurance product or redeem your NDA in full. If this occurs, your MAPIA investment will terminate immediately. Your MAPIA investment can also be terminated by you or us under the terms of your MAPIA Service Agreement.

- **Primary Features of the NDA.** The NDA has many features that make it a flexible investment option for clients seeking primarily to ensure that they have a retirement portfolio that may grow over time while providing a guaranteed stream of income at retirement.

The principal features of the NDA are:

- **Sales Charges.** There are no initial sales charges assessed on investment purchase payment.
- **Fees and Deductions.** Nationwide deducts a number of fees from your ongoing investment in the NDA. Those fees are described in more detail in the NDA prospectus. The fees we believe are most relevant to a MAPIA investor are:
  - **Mortality and Expense Risk Fee.** Nationwide deducts a mortality and expense risk fee from the NDA. This fee is computed on a daily basis and is equal to an annualized rate of 0.20% of the NDA Daily Net Assets. This fee compensates Nationwide for providing insurance benefits, assuming the risk that annuitants will live longer than assumed and guaranteeing the NDA fees will not increase regardless of actual expenses.
  - **Administrative Fee.** Nationwide deducts an administrative fee from the NDA equal to an annualized rate of 0.20% of the daily net assets of the NDA. This fee is computed on a daily basis and reimburses Nationwide for various administrative costs it incurs in connection with providing contract benefits.
  - **Lifetime Income Track Fee.** Nationwide deducts an annual fee of 0.80% of the Guaranteed Lifetime Withdrawal Base to pay Nationwide for providing Lifetime Income Track from the NDA. The fee is deducted on each contract anniversary and is taken from the NDA sub-accounts. If you surrender your entire NDA contract, a prorated fee will be deducted.
  - **Joint Option Fee.** If you elect to purchase the Joint Option, Nationwide will deduct an annual fee of 0.15% of the Guaranteed Lifetime Withdrawal Base. This fee is deducted at the same time and in the same manner as the Guaranteed Lifetime Withdrawal Fee described above.
  - **Underlying Mutual Fund Expenses.** The underlying mutual funds charge fees and expenses that are deducted directly from underlying mutual fund assets in which you invest. These fees and expenses are in addition to the other fees and expenses assessed by Nationwide and described above and assessed by Waddell & Reed and described below. The statutory prospectus for each underlying mutual fund in which you invest provides detailed information regarding the fees and expenses applicable to each underlying mutual fund. Please ask your Financial Advisor for more detailed information regarding these fees and charges.
- **Lifetime Income Track and Joint Option.** The NDA has two key features that we believe make it especially appropriate for investors seeking guaranteed cash withdrawals on a predictable basis for their life and the life of their spouse. These key features are:
  - **Lifetime Income Track.** This feature of the NDA is designed exclusively to provide lifetime withdrawal benefits to the NDA owner. Nationwide determines a income benefit base that it uses to calculate how much the contract owner can withdraw each year after the contract owner reaches age 59 ½ (or if the Joint option is elected, both spouses reach

age 50½). Once the contract owner reaches this date, the Lifetime Income Track provides lifetime withdrawals of the Guaranteed Lifetime Withdrawal amount, even after the NDA value is zero, subject to the various definitions, terms and conditions discussed in the NDA prospectus. Please read the prospectus and discuss any questions with your Financial Advisor.

- **Joint Options.** The Joint Option allows a surviving spouse to continue to receive, for the duration of his/her lifetime, the benefit associated with the Lifetime Income Track discussed above. This feature is beneficial in that it provides the security of knowing that both spouses have access to the Lifetime Income Track for the duration of both their lives. In order to obtain this feature, the contract owner must elect to add it at the time they make application for the NDA, and both spouses cannot be older than 85 at that time. Once the Joint Option is elected, it may not be removed from the NDA except under certain limited circumstances described in the NDA prospectus.

**Investment Options.** There are currently multiple investment options offered in connection with the NDA. One of those options is Ivy Funds VIP Pathfinder Portfolios (Portfolios). These Portfolios are created and managed by an affiliate of Waddell & Reed. Therefore, your Financial Advisor may recommend that you invest in the Pathfinder Portfolios because they receive more training and education on and have more educational material for the Pathfinder Portfolios than other NDA investment options. However, this presents certain conflicts of interest between you and Waddell & Reed and your Financial Advisor. Please refer to the discussions about Conflicts of Interest elsewhere in this brochure.

**Note: Anything herein to the contrary notwithstanding, Waddell & Reed may change, modify or terminate the MAPIncome program at any time in its sole discretion.**

## Important Information for MAPIncome Clients

- **Fund Performance.** There is no assurance that the mutual funds selected for your MAPIncome program will perform in any particular manner. Past performance of a mutual fund or asset class is no guarantee of future performance. Clients must carefully read the prospectus of each mutual fund selected for MAPIA before investing.
- **Mutual Fund Fees and Expenses.** The asset-based fee described above does not cover the underlying fees and expenses of the mutual funds selected for MAPIA, as specifically described in each mutual fund's prospectus. The mutual fund's fees and expenses will reduce a client's investment return. Each mutual fund's current fees and expenses may vary significantly in future years.
- **Other Asset Allocation Programs May Be Less Expensive.** Clients may be able to invest in similar asset allocation programs through other sponsors that have lower asset-based and other fees and expenses and provide better performance than MAPIA.
- **Conflicts.** MAPIA involves significant conflicts of interest. Clients must read carefully the sections of this brochure and the prospectus for each mutual fund and the NDA that describe and discuss those conflicts before investing.
- **Dividends and Capital Gains.** Dividend and capital gain distributions paid by the Waddell & Reed Mutual Funds held in a MAPIA account will be automatically reinvested in additional mutual fund shares and will not be paid to clients.
- **Inappropriate Client Activity.** Clients are cautioned that redeeming Waddell & Reed Mutual Funds or selling shares of other mutual funds, particularly Class A shares on which a load was paid or Class B or C shares subject to a CDSC, to use the cash proceeds to purchase Waddell & Reed Mutual Funds at



NAV in MAPIA may subject you to adverse tax consequences. Such redemptions may also be unsuitable. Waddell & Reed may terminate the MAPIA Service Agreement with clients who are determined to have engaged in such activity.

- **Risks Related to NDA.** A variable annuity is a long-term, tax-deferred investment vehicle designed for retirement. Earnings are taxable as ordinary income when distributed, and if withdrawn before age 59 ½, may be subject to a 10% federal tax penalty. If the annuity will fund an IRA or other tax qualified plan, the tax-deferred feature offers no additional value. There are charges and expenses associated with annuities. Variable annuities have additional expenses such as mortality and expense risk, administrative charges, investment management fees and rider fees. Variable annuities are subject to market fluctuation, investment risk and loss of principal. You can purchase the NDA outside MAPIncome, in which case you will not be required to pay the MAPIncome asset-based fee charged on the NDA.

You should consider the investment objectives, risks, charges and expenses of the NDA carefully before investing. The NDA and the prospectus for the underlying portfolio in which you elect to invest contain this and other information. You may obtain a copy of each prospectus from your Financial Advisor. Please read the prospectuses carefully before investing.

## Third Party Money Managers

Waddell & Reed, Inc. may act as a solicitor and allow its Financial Advisors to refer clients to unaffiliated third party investment advisers offering asset management and other investment advisory services. Waddell & Reed is paid a portion of the fee charged and collected by the third party Adviser in the form of solicitor fees. Each solicitation arrangement is performed pursuant to a written solicitation agreement, which will comply with SEC Rule 206(4)-3 and applicable state securities rules and regulations. Waddell & Reed only enters into relationships with a select number of third party Advisers that pass the Waddell & Reed due diligence process.

Through these programs Waddell & Reed will recommend third party Advisers that offer Advisory products consistent with the client's stated investment objectives and risk tolerance. The client may then select a recommended third party Adviser. Clients will then enter into a written agreement directly with the unaffiliated third party Adviser.

Waddell & Reed Financial Advisors are available to answer questions the client may have regarding their account and act as a communication conduit between the client and the Adviser. Investment Advisers may take discretionary authority to determine the securities to be purchased and sold for the client. Neither Waddell & Reed nor its Financial Advisors will have any trading authority with respect to a client's managed account with the Adviser(s).

Investment Advisory programs generally have account minimums that will vary from Adviser to Adviser. A complete description of the third party Adviser's services, fees schedules and account minimums will be disclosed in the third party Advisers Form ADV Part 2A or similar Disclosure Brochure which will be provided to the clients at the time of the initial solicitation.

The actual charge to a client will vary depending on the Advisor selected. All fees are calculated and collected by the selected by Adviser who shall be responsible for delivering Waddell & Reed's portion of the client fee to Waddell & Reed. Clients may incur additional charges including but not limited to mutual fund sales loads, 12b-1 fees, surrender charges and IRA and qualified retirement plan fees. Waddell & Reed will not receive any portion of such commissions or fees. Waddell & Reed is only compensated by

the solicitor feed described above. Waddell & Reed receives no other compensation in connection with the client's account. Therefore the client will not pay more to use a solicitor than they would to engage the Adviser directly.

## Value of Total Assets Under Management

Waddell & Reed had as of December 31, 2012, total assets under management in the amount of \$10,079,875,604.

\$1,795,241,106 of these assets are technically considered to be managed using discretion because Waddell & Reed may, from time to time, take actions without prior client consent to rebalance portfolios to ensure the portfolio matches the client's asset allocation model.

## Fees and Compensation

### SPA Fee Schedule

Clients in SPA pay Waddell & Reed an advisory fee in accordance with the schedule below. A certain percentage of each client's SPA account will be allocated to the SPA Cash Management Fund from which the advisory fee will be paid. This allocation may impact the performance of SPA accounts. The fee will be collected by Waddell & Reed quarterly in arrears from the SPA Cash Management Fund. The fee will be computed and applied after the last day of each calendar quarter, and reported on the quarterly statement received by clients during the quarter after it is collected. Upon termination of an agreement prior to a quarter's end, the fee will be prorated. Advisory fees are subject to change at any time. Clients may terminate this SPA Services Agreement immediately by delivering written notice of termination to Waddell & Reed, as provided in the SPA Service Agreement. Waddell & Reed reserves the right to offer SPA advisory services, free of charge, to employees of Waddell & Reed Financial, Inc. (Waddell & Reed, parent company) and its subsidiaries, to Financial Advisors and account representatives of Waddell & Reed, to directors and officers of the registered investment companies for which Waddell & Reed, or its affiliates serves as distributor, and to the spouse, children, parents, children's spouses and spouse's parents of each such employee, Financial Advisor, account representative, director and officer. "Child" includes stepchild; "parent" includes stepparent.

<b>Mutual Fund Annual Fee Rate*</b>	<b>Average Daily Account Value During Quarter</b>	<b>Models</b>
2.25%	First \$150,000.00	Appreciation and Aggressive
2.00%	Next \$350,000.00	Appreciation and Aggressive
1.75%	Next \$500,000.00	Appreciation and Aggressive
1.50%	\$1,000,000.01 or greater	Appreciation and Aggressive
2.00%	Any	Conservative, Balanced and Growth

*\*The higher fee rate will apply to account balances up to and including the stated amounts, even if the account balance exceeds the maximum account value range applicable to the stated fee rate. Lower fee rates will apply only to the balance of the account in excess of the stated amounts. Currently, Class A shares purchased with applicable sales charges will not be eligible to be included in a SPA Account unless they were purchased three (3) years or more prior to their transfer to a SPA Account.*

## MAP Program Account Fee Schedule

**Prospective MAP Investors must read carefully the following discussion of the MAP contingent fee before you decide to invest in MAP.**

### *Contingent Fee Disclosure*

**Contingent Fee.** Waddell & Reed will pay its financial advisors compensation each time a client invests assets in a MAP account. Advisors will be compensated blended compensation at the rate of up to 2.34% of the value of all assets invested in MAP accounts. This compensation does not apply to investments in MAPPlus accounts. The purpose is to compensate the Financial Advisor for services they will provide in connection with the establishment of a MAP account. These services include:

- determining whether a potential client is eligible for a MAP account and recommending another alternative to those who are not;
- speaking with potential clients in detail about, and answering questions with respect to MAP, in order to explain how a MAP account can potentially assist clients achieve their individual investment goals;
- helping potential clients complete the MAP questionnaire;
- discussing the recommended asset allocation and fund selection options;
- opening an account for new MAP clients; and
- arranging for the Waddell & Reed Mutual Funds selected by the client to populate their asset allocation model.

The compensation paid to the Financial Advisor is advanced by Waddell & Reed and is not deducted from the client's assets invested in their MAP account and no sales charge is paid to Waddell & Reed upon the purchase of Waddell & Reed Mutual Funds in a MAP account.

### **Account Termination or Account Withdrawals**

Except in certain limited situation described below, if the client terminates their MAP account for any reason during the first three years after such assets were invested in the MAP Account, the compensation originally advanced by Waddell & Reed to the financial advisor will be recouped by Waddell & Reed by deducting the following amounts from the proceeds prior to sending them to the client.

- First year — 3% of the amount invested by the client in the MAP Account (without giving effect to any appreciation in the account). This applies to the initial investment and any subsequent investments.
- Second year — 2% of the amount invested by the client in the MAP Account (without giving effect to any appreciation in the account). This applies to the initial investment and any subsequent investments.
- Third year — 1% of the amount invested by the client in the MAP Account (without giving effect to any appreciation in the account). This applies to the initial investment and any subsequent investments.
- Fourth year — Zero.
- The Contingent Fee schedule described above will apply to initial investments as well as all subsequent investments in the MAP account throughout the life of the account. These contingent fees are in addition to the asset-based fee charged to the client on a quarterly basis but are only charged at the time of a withdrawal or the closing of the account. The contingent fee, if any, will be determined according to a formula selected by Waddell and Reed in its sole discretion. The formula may be changed at any time and may be applied to all withdrawals on a pro-rata basis if an

account contains both CDSC liable and non-labile shares.

- The Contingent Fee may act as a disincentive to clients who wish to terminate their MAP account.
- Clients must consider that, if they terminate their MAP account during the first three years after inception the fees will be charged. This includes termination for reasons such as; a change in their Financial Advisor, a change of personnel at Waddell & Reed or any affiliates, a change in the overall investment strategy of MAP or changes in the performance of the client's selected MAP asset allocation model and/or selected mutual funds.
- MAP account clients may withdraw assets from their MAP accounts during the first three years under the following limited circumstances without Waddell & Reed recouping any of the contingent compensation paid to the Financial Advisor from these withdrawals, as follows:
- Clients may withdraw assets from their MAP account through a systematic withdrawal service without being assessed a Contingent Deferred Sales Charge (CDSC), so long as the withdrawals, during a 12 month period, do not exceed 12% of the MAP account value at the time the service is established or modified and so long as the total withdrawals do not cause the MAP account value to fall below the then minimum account value necessary to establish a MAP account. Withdrawals are allowed to be established on a monthly, quarterly or semi-annual schedule, not on an annual withdrawal basis.
- Withdrawals requested within one year from the date of a client's death or disability, so long as Waddell & Reed is notified in writing at its corporate headquarters of the death or disability and the person requesting the withdrawal provides proof of the death or disability satisfactory to Waddell & Reed in its sole discretion. The withdrawal must also not cause the account to fall below the then minimum account value necessary to establish a MAP account.
- Withdrawals necessary to satisfy a required minimum distribution from a retirement account as provided for under the then current provisions of the IRS code.

**Asset-Based Fees.** Clients who participate in MAP or MAPPlus will pay an ongoing asset-based fee to cover the cost of such services as consulting and administrative services, creation and continual maintenance of the proprietary tool used to select asset category percentages in MAPPlus accounts, ongoing monitoring of and periodic revisions of the model portfolios, and services provided by each client's Financial Advisor, including annual and other periodic meetings for account reviews, answering client inquiries, assistance with annual tax reporting on account performance and meeting with clients as required to reassess the propriety of their current asset allocation model selection. Fees are computed on the average daily assets of the previous quarter. MAP Program accounts will be allocated in a manner so that the cash asset class will be targeted at approximately 2% of the overall MAP Program account value. The cash portion of MAP Program accounts will be maintained in the Cash Management. Nevertheless, if during any quarter there is insufficient cash in an account to pay the MAP Program fee, Waddell & Reed may in its sole discretion sell shares of the mutual funds held in the account in amounts necessary to raise sufficient cash to pay the quarterly fee. Quarterly MAP Program fees will be deducted automatically from the Cash Management fund. Contingent Deferred Sales Charge (CDSC) will not be assessed on liable shares Waddell & Reed may change these fees at any time in its sole discretion. Clients may terminate their MAP Program Account immediately by delivering written notice of termination to Waddell & Reed, as provided in the MAP Service Agreement. Waddell & Reed may offer MAP Programs with no fee to employees of Waddell & Reed Financial, Inc. and its subsidiaries, to Financial Advisors, to officers and directors of the investment companies for which Waddell & Reed and/or its affiliates act as distributor, and

to any spouse, children, parents, children's spouse and the parents of such spouse of each employee, Financial Advisor, director and officer. The term "child" includes stepchild. The term "parent" includes stepparent. The current fees for MAP are described below:

### MAP Fees

<u>Value of Assets</u>	<u>Program Fee 1, 2, 3, 4, 5</u>
On the first \$300,000.00	1.30%
On the next \$700,000.00	1.05%
On assets in excess of \$1 million	0.55%

### MAPPlus Fees

<u>Value of Assets</u>	<u>Program Fee 1, 2, 3, 4, 5</u>
On the first \$300,000.00	1.50%
On the next \$700,000.00	1.25%
On assets in excess of \$1 million	0.75%

1. Assuming a client invests more than \$300,000 in one of the MAP Programs, the net effective fee will be a weighted average of the schedule fee rates, and will change with the account's asset level.
2. The client's Financial Advisor will not be paid any portion of the applicable asset-based fee charged to MAP accounts during the first three years after the account is established if contingent fees could be charged due to the blended compensation paid to the advisor.
3. Assets transferred from existing MAP accounts into MAP Program accounts will be charged current MAP Program fees beginning on the date the new MAP Program account is established.
4. Class A shares originally purchased with a sales load may not be transferred into the MAP Programs unless the transaction in which the shares were acquired occurred at least three years prior to the execution of the client's MAP Service Agreement.
5. Each mutual fund in the MAP Programs pays an ongoing distribution and service (12b-1) fee to Waddell & Reed. Some or all of this fee may be paid to the client's Financial Advisor in addition to the fees described above. This fee will be paid from the date the mutual fund shares are purchased.

### MAP Income Fee Schedule

The fees charged on the assets in the MAPIA portion of MAPIncome are the same as those charged on assets in any MAP Program account except that there will be no contingent fees. Therefore, clients should disregard the discussion of the contingent fee in the Managed Allocation Portfolios section of this brochure. The entire asset based fee for the program (assessed on the MAPIA portfolio and the Nationwide Destination Architect portfolio) will be taken from the MAPIA portfolio.

Clients will also pay an ongoing asset-based fee on the NDA sub-account assets to Waddell & Reed that is assessed, calculated and paid on the same basis and for essentially the same services as the asset-based fee charged to your MAPIA account. Please refer to the discussion of asset-based fees in the Managed Allocation Portfolio section of this brochure. All asset-based fees for MAPIncome, including the NDA asset-based fee, will be taken from the MAPIA account. Please discuss any questions about the ongoing asset-based fee paid to Waddell & Reed in connection with your purchase of the NDA with your Financial Advisor.

## Account Grouping

Balances in multiple Advisory Program accounts may be aggregated for purposes of determining the applicable fees rate based on Account Grouping. Only accounts within the same Program type and that qualify for Account Grouping will be aggregated for purposes of determining applicable fee rates (i.e. – MAP accounts may be grouped with related MAP accounts but not with related MAPPlus or SPA accounts, etc.).

Account Grouping: Grouping accounts in the same Program by certain related persons – the account owner and the accounts of household members of their immediate family (spouse, parents and children under 21).

Account Grouping is allowed only for:

- Accounts of the owner that have the same address or taxpayer identification number and
- Accounts of family members living (or maintaining a permanent address) in the same household as the owner. An individual's domestic partner may be treated as his or her spouse.
- Accounts within the same MAP, MAPPlus or SPA Program (i.e., MAP accounts may be grouped with related MAP accounts but not with related MAPPlus or SPA accounts, etc.). The MAPIncome program is excluded from account grouping.
- In order for related accounts to be grouped for purposes of determining the applicable fee rates, that account owner must advise Waddell & Reed at the time the account is opened that it is eligible for grouping and identify the accounts with which it may be grouped.

## Conflicts of Interest

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 clients purchase the Waddell & Reed Mutual Funds. Employees of Waddell & Reed and its affiliates may indirectly receive higher compensation and other benefits when clients 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 the company are tied to varying degrees to Waddell & Reed's 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 individual financial advisor are compensated when you buy mutual funds and variable insurance products through Waddell & Reed. Generally, your financial advisor receives a substantial portion of the sales charge and distribution and shareholder service (12b-1) fees you pay in connection with your purchase. Sales charges and 12b-1 fees vary among products and, for mutual funds, among share classes. In addition to sales charges discussed above, you also pay a portion of the product's internal operating expenses.



Sales charges are paid to compensate Waddell & Reed and your Financial Advisor for the assistance they provide in helping you select suitable investments and ongoing costs associated with servicing your accounts.

Operating expenses include: fees paid for investment management (research, trading, portfolio manager compensation, administrative services and technology), distribution and shareholder service fees paid for ongoing service provided by Waddell & Reed and your Financial Advisor, and other expenses such as record keeping, portfolio accounting, regulatory reporting, audit, legal and other non-investment expenses. A significant portion of the distribution and shareholder service fees may be paid to your Financial Advisor as compensation on an ongoing basis.

For additional information, you should review carefully the summary prospectus and, where applicable, statement of additional information for the particular product you are considering. If you invest in one or more of the fee-based investment advisory products described in this brochure, you will pay an ongoing asset-based fee for advice concerning the investment of your assets in these programs. These fees are separate from, and in addition to, any financial planning fee you incur. It is possible that you will pay a financial planning fee for a financial plan that, among other things, recommends the use of one of our fee-based investment advisory products in which case you will pay an additional fee on the same assets for participating in these products.

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.

## Client Referrals and Other Compensation

Please read carefully the “Conflicts of Interest” section above to learn more about how Waddell & Reed and your financial advisor may benefit when you purchase Waddell & Reed Mutual funds. Neither Waddell & Reed nor your Financial Advisor may compensate anyone directly or indirectly for client referrals.

Waddell & Reed offers a wide variety of products and programs including mutual funds, annuities and life insurance and investment advisory products. Waddell & Reed has entered into several arrangements with certain available product companies referred to as revenue sharing arrangements. Although Waddell & Reed strives at all times to place the interest of its clients ahead of its own or those of its officers, directors or representatives (“affiliated persons”), these arrangements could affect the judgment of Waddell & Reed or its affiliated persons when recommending investment products. Because these situations may present a conflict of interest that can affect the judgment of our advisors, Waddell & Reed believes it is important to make you aware of our revenue sharing arrangements.

Nationwide Life Insurance Company (Nationwide) and Minnesota Life Insurance Company (Minnesota Life) each pay W&R compensation, in addition to commissions for providing administrative and marketing services. Nationwide pays

compensation to Waddell & Reed on a monthly basis in an amount equal to 0.244% annually of the average daily account value of all variable annuity assets for Nationwide products distributed by Waddell & Reed prior to January 1, 2012, and 0.22% annually of the average daily account value of all variable annuity assets for Nationwide products distributed by Waddell & Reed after January 1, 2012. Minnesota Life pays compensation to Waddell & Reed on a quarterly basis in an amount equal to 0.25% annually of the average daily account value of all variable annuity assets for products distributed by Waddell & Reed.

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

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

## Types of Clients

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

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

*Please read carefully the discussion in Advisory Business above to learn more about the account minimums for investing in and maintaining an investment in the investment advisory programs discussed in Advisory Business.*

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

Waddell & Reed typically recommends a broad asset allocation strategy across a number of common asset classes. These asset classes are represented in the model portfolios of the various asset allocation programs discussed in this brochure.

Asset allocation 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 Asset allocation programs described are based primarily on an investment concept known as Modern Portfolio Theory, which states that through diversification you may be able to minimize the effects of investment risks and that gains in one investment class may help offset losses in another. There is no certainty that any investment or strategy will be profitable or successful in achieving your specific investment objectives. Principal values of your investments will fluctuate and, when redeemed, may be worth more or less than your original investment. Asset allocation does not ensure a profit or protect against losses 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.

We do not believe that the mutual funds and asset allocation programs described in this brochure involve significant or unusual risks to our clients. Clients should consider carefully before investing in one or more of the Advisors products described in this brochure.

- Depending on your anticipated trading volume it may be less expensive to pay commissions in a traditional brokerage account than to pay a wrap fee to participate in an advisory product that charges and asset-based charge. This is especially important to clients that intend to buy and hold securities over the long term.
- Investment Advisory products, including mutual fund asset allocation and wrap fee products sponsored by other investment advisers may be less expensive, invest in mutual funds and other packaged products with lower internal expenses and have better performance than the advisory products discussed in this brochure.

## 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.

On January 15, 2013, a Letter of Acceptance Waiver and Consent (No. 2011029075101) was approved by FINRA relating to the failure of the firm to deliver purchase confirmations for a period of time. The firm failed to deliver numerous purchase confirmations for mutual-fund asset-allocation products accounts (MAP), during a period, and those confirmations would have confirmed multiple mutual fund share purchases that occurred in numerous investment-advisory accounts. Although the failure to deliver purchase confirmations resulted from the actions of a third-party service provider, the firm remained responsible at all times for compliance with its obligations under all applicable securities laws and regulations. The firm's investment-advisory offerings include several MAP accounts. The firm contracts with its subsidiary to act as the transfer agent for the mutual funds that can be held in the MAP accounts and the subsidiary was obligated to send purchase confirmations on behalf of the firm to MAP-account customers. The firm's subsidiary, in turn, contracts with a third-party service provider to generate and deliver those confirmations. Until a certain date, all purchase transactions in MAP accounts resulted in the delivery of contemporaneous trade confirmations. On that

date, however, the third-party service provider made a coding change to the software system that it provided to the subsidiary and other entities. The third party did not intend for the coding change to affect the MAP accounts in any way, and neither the subsidiary nor the firm requested the change. Nonetheless, one effect of the coding change was to prevent customers from receiving confirmations when cash in a MAP account was allocated to individual mutual funds. Thereafter, a MAP-account customer contacted a representative of the firm to ask why the firm was no longer issuing fund-allocation confirmations. The representative contacted the subsidiary, but did not alert the firm's compliance department of the situation. The subsidiary conducted an internal review and determined that the subsidiary's coding change had created the problem. The subsidiary also did not apprise the firm's compliance department of the situation at that time. Thereafter, the subsidiary began researching the issue and working on a solution. The subsidiary's initial work did not completely solve the problem and it implemented a second fix, which through subsequent testing verified that the problem was fully resolved. Without admitting or denying FINRA's allegations, Waddell and Reed agreed to a censure and fine of \$75,000 to settle the regulatory action.

## Other Financial Industry Activities and Affiliations

Waddell & Reed is registered as a broker-dealer and investment advisor. Investment advisor representatives are also registered representatives of the broker-dealer. As such, your Financial Advisor may offer to both our financial planning services, various asset allocation and wrap programs, some of which are sponsored by Waddell & Reed and general securities products including:

- 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 relationships and arrangements that are material to its asset allocation programs with the following:

**Waddell & Reed Mutual Funds:** Please read carefully the discussion above under Fees and Compensation, Other Fees and Compensation regarding the conflicts of interest inherent in the relationship between Waddell & Reed and the Waddell & Reed Mutual Funds. The investment managers for the Waddell & Reed Mutual Funds are Waddell & Reed Investment Management Company and Ivy Investment Management Company, wholly owned subsidiaries of Waddell & Reed.

**W&R Insurance Agency:** Waddell & Reed distributes certain fixed and variable insurance products through its affiliate, W&R Insurance Agency. These products include the insurance products created for Waddell & Reed by the Strategic Partners.

**Strategic Partners:** We discuss our relationship with the Strategic Partners under Advisory Business, Overview and Ownership above. Most of the variable insurance products we sell are created by our Strategic Partners. We earn standard commissions on the sale of these products. We also receive a percent of the value of the assets held in the sub-accounts on an ongoing basis.

## Code of Ethics

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.

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

## Brokerage Practices

The Waddell & Reed Mutual Funds and the NDA described under Advisory Business, Managed Allocation Portfolio Income above are purchased on a direct check and application basis from the product sponsor through Waddell & Reed. We do not select or direct clients to any other broker-dealer for client transactions in connection with the asset allocation programs discussed in this brochure.

## 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 business 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.

Client accounts are reviewed and examined periodically at various supervisory levels of Waddell & Reed. Managing Principals determine the suitability of each SPA, MAP Program and MAPIA investment based on a risk analysis. Managing Principals conduct frequent reviews of client accounts for conformity with company policy and procedures.

Clients receive regular quarterly reports with respect to their Waddell & Reed Mutual Funds investments, quarterly and other reports with respect to SPA, MAP programs, and MAPIA advisory services purchased through Waddell & Reed, and quarterly and other reports from the issuers of certain products they hold.

Financial Advisors must meet with SPA, MAP programs, and MAPIncome participants at least annually to determine whether

their financial situations or investment objectives have changed or whether they want to impose or modify any reasonable restrictions on the management of their accounts. Such information is recorded and maintained by the participants' Financial Advisors and retained in the division office files.

## **Custody**

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The Waddell & Reed Mutual Funds you purchase to fund your SPA, MAP programs and/or MAPIncome program account are maintained on the books and records of the respective Waddell & Reed Mutual Funds or, in the case of the MAPIncome NDA, on the books and records of Nationwide. You will receive quarterly statements from the Waddell & Reed Mutual Funds and Nationwide along with the Confirmation of Purchase and Sales and Withdrawals. Your Financial Advisor is permitted to send our COMPASS report account summary and related performance reports. However, the COMPASS reports are merely unofficial account summaries and must not be relied on as an accurate, complete statement of your account holdings, activity, or performance.

## **Investment Discretion**

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We do not accept discretionary authority from clients to manage their securities accounts. We do exercise discretion indirectly within our MAP asset allocation programs only to the extent necessary to rebalance your portfolio periodically to remain consistent with the investment model you select.

## **Voting Client Securities**

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

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

Consolidated Balance Sheet

December 31, 2012

(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, a wholly owned subsidiary of Waddell & Reed Financial, Inc., as of December 31, 2012, that is filed pursuant to Rule 17a-5 under the Securities Exchange Act of 1934, and the related notes to the consolidated balance sheet (consolidated financial statement).

### **Management's Responsibility for the Financial Statement**

Management is responsible for the preparation and fair presentation of this consolidated financial statement in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statement that is free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

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 consolidated financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## **Opinion**

In our opinion, the consolidated financial statement referred to above presents fairly in all material respects, the financial position of Waddell & Reed, Inc. and subsidiaries as of December 31, 2012, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Kansas City, Missouri  
February 27, 2013

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

Consolidated Balance Sheet

December 31, 2012

(In thousands)

**Assets**

Cash and cash equivalents	\$ 166,454
Cash and cash equivalents – restricted	92,980
Investment securities	71,248
Receivables:	
Funds and separate accounts	29,822
Customers and other	135,413
Due from affiliates	11,497
Deferred income taxes	6,118
Prepaid expenses and other current assets	7,712
Income taxes receivable	3,625
	<hr/>
Total current assets	524,869
Property and equipment, net	67,543
Deferred sales commissions, net	41,496
Deferred income taxes	25,216
Goodwill and identifiable intangible asset	35,095
Other assets	4,918
	<hr/>
Total assets	\$ 699,137

**Liabilities and Stockholder's Equity**

Accounts payable	\$ 65,605
Payable to investment companies for securities	152,749
Accrued compensation	25,936
Payable to third party brokers	13,472
Other current liabilities	29,030
	<hr/>
Total current liabilities	286,792
Accrued pension and postretirement costs	51,119
Other noncurrent liabilities	20,955
	<hr/>
Total liabilities	358,866
	<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	220,389
Retained earnings	161,354
Accumulated other comprehensive loss	(41,473)
	<hr/>
Total stockholder's equity	340,271
	<hr/>
Total liabilities and stockholder's equity	\$ 699,137

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, 2012

**(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**  
(A Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Notes to Consolidated Balance Sheet

December 31, 2012

evaluated subsequent events through February 27, 2013, 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 upon acquisition 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 and Investments in Affiliated Mutual Funds***

Our investment securities are comprised of state and government obligations, corporate debt securities, and investments in affiliated mutual funds. Investment securities are classified as available for sale or trading. 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 other than temporary impairment recognized in earnings is equal to the entire difference between the

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2012

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, and fixtures, one to 10 years for computer software; two to five years for data processing equipment; 10 to 30 years for buildings; three to 26 years for equipment and machinery; 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 \$9.4 million as of December 31, 2012. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally one 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.

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

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

Notes to Consolidated Balance Sheet

December 31, 2012

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 and Ivy Funds VIP and the Company. The majority of investment management fees earned from

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

Notes to Consolidated Balance Sheet

December 31, 2012

institutional and separate accounts are charged quarterly based upon an average of net investment management assets under management in accordance with such agreements.

Underwriting and distribution commission 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 for certain types of investment products, primarily variable annuity products that 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 InvestEd and service agreements with 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 when contractual obligations are fulfilled or as services are provided.

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, information technology, legal, marketing, rent and other administrative services to affiliated companies.

**(I) *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 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

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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. The excess tax benefits from share-based payments were \$5.9 million for 2012.

**(2) Investment Securities**

Investments at December 31, 2012 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	1	—	10
Corporate bonds	6,645	52	—	6,697
Affiliated mutual funds	21,847	1,521	—	23,368
Total available-for-sale securities	<u>\$ 28,501</u>	<u>1,574</u>	<u>—</u>	<u>30,075</u>
Trading securities:				
Mortgage-backed securities				44
Municipal bonds				500
Corporate bonds				12,112
Common stock				38
Affiliated mutual funds				28,479
Total trading securities				<u>41,173</u>
Total investment securities				<u>\$ 71,248</u>

Mortgage-backed securities and corporate bonds accounted for as available for sale as of December 31, 2012 mature as follows (in thousands):

	<u>Amortized cost</u>	<u>Fair value</u>
After one year but within ten years	\$ 6,654	6,707

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**WADDELL & REED, INC. AND SUBSIDIARIES**  
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Mortgage-backed securities, municipal bonds and corporate bonds accounted for as trading and held as of December 31, 2012 mature as follows (in thousands):

	<u><b>Fair value</b></u>
Within one year	\$ 2,531
After one year but within ten years	<u>10,125</u>
	<u><u>\$ 12,656</u></u>

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 that 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.
- 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. 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. The fair value of municipal bonds is measured based on pricing models that take into account, among other factors, information received from market makers and broker/dealers, current trades, bid-wants lists, offerings, market movements, the callability of the bond, state of issuance and benchmark yield curves. The fair value of corporate bonds is measured using various techniques, which consider recently executed transactions in securities of the issuer or comparable issuers, market price quotations (where observable), bond spreads and fundamental data relating to the issuer.

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.

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The following table summarizes our investment securities as of December 31, 2012 that are recognized in our consolidated balance sheet using fair value measurements based on the differing levels of inputs. There were no transfers between levels for the year ended December 31, 2012.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(In thousands)			
Mortgage-backed securities	\$ —	54	—	54
Municipal bonds	—	500	—	500
Corporate bonds	—	18,809	—	18,809
Common stock	38	—	—	38
Affiliated mutual funds	51,847	—	—	51,847
Total	<u>\$ 51,885</u>	<u>19,363</u>	<u>—</u>	<u>71,248</u>

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

Goodwill represents the excess of purchase price over the tangible assets and the identifiable intangible asset of acquired business. Our goodwill is not deductible for tax purposes. Goodwill and the identifiable intangible asset (all considered indefinite lived) at December 31, 2012 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>\$ 35,095</u>

In 2012, the Company's annual impairment test indicated that goodwill and the identifiable intangible asset summarized in the table above were not impaired.

**(4) Property and Equipment**

A summary of property and equipment at December 31, 2012 is as follows (in thousands):

		<u>Estimated useful lives</u>
Furniture and fixtures	\$ 29,698	3 – 10 years
Data processing equipment	19,698	2 – 5 years
Computer software	71,458	1 – 10 years
Equipment	19,492	3 – 26 years
Leasehold improvements	19,520	1 – 15 years

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		<u>Estimated useful lives</u>
Building	\$ 5,284	10 – 30 years
Land	<u>1,940</u>	
Property and equipment, at cost	167,090	
Accumulated depreciation	<u>(99,547)</u>	
Property and equipment, net	<u><u>\$ 67,543</u></u>	

At December 31, 2012, we have property and equipment under capital lease with a cost of \$1.9 million and accumulated depreciation of \$790 thousand.

**(5) Income Taxes**

The provision for income taxes for the year ended December 31, 2012 consists of the following (in thousands):

Currently payable:	
Federal	\$ 63,525
State	<u>5,032</u>
	68,557
Deferred taxes	<u>(3,595)</u>
Provision for income taxes	<u><u>\$ 64,962</u></u>

The following table reconciles the statutory federal income tax rate to the Company's effective income tax rate:

Statutory federal income tax rate	35.0%
State income taxes, net of federal tax benefits	1.8
Valuation allowance	(1.7)
Other items	<u>(0.3)</u>
Effective income tax rate	<u><u>34.8%</u></u>

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The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2012 is presented as follows (in thousands):

Deferred tax liabilities:		
Unrealized gains on investment securities	\$	(588)
Deferred sales commissions		(146)
Property and equipment		(9,094)
Benefit plans		(9,791)
Purchase of fund assets		(6,280)
Prepaid expenses		(1,770)
		<hr/>
Total gross deferred liabilities		(27,669)
Deferred tax assets:		
Capital loss carryforward		169
Additional pension and postretirement liability		25,154
Accrued expenses		11,774
Nonvested stock		17,749
State net operating loss carryforwards		4,070
Federal benefit on state liabilities		2,288
Unused state tax credits		970
Other		801
		<hr/>
Total gross deferred assets		62,975
Valuation allowance		(3,972)
		<hr/>
Net deferred tax asset	\$	<u>31,334</u>

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, 2012, is approximately \$0.2 million. As of December 31, 2012, other net deferred tax liabilities, which are capital in nature, are approximately \$0.5 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 in certain state jurisdictions in which the Company files. Accordingly, a valuation allowance in the amount of \$0.1 million has been recorded at December 31, 2012. During 2012, realized gains on the sale of investment securities and increases in the fair value of the Company's available for sale securities portfolio allowed for a reduction in the valuation allowance of \$3.2 million.

As of December 31, 2012, 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, 2012. The carryforwards, if not utilized, will expire between 2013 and 2032. Management believes it is not more likely than not that the Company will generate

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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, 2012. The Company has state tax credits of \$1.0 million as of December 31, 2012 that can be utilized in future tax years. Of these state tax credit carryforwards, \$0.7 million will expire between 2024 and 2028 if not utilized and \$0.3 million will expire in 2026 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration dates.

As of January 1, 2012, 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. As of December 31, 2012, the Company had unrecognized tax benefits, including penalties and interest, of \$7.6 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, 2012, the total amount of accrued interest and penalties related to uncertain tax positions included in the consolidated balance sheet was \$2.1 million (\$1.7 million net of federal benefit). The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2012 of \$2.3 million (\$1.8 million net of federal benefit) is included in the total unrecognized tax benefits described above.

The following table summarizes the Company's reconciliation of unrecognized tax benefits (excluding penalties and interest) for the year ended December 31, 2012 (in thousands):

	<b>Unrecognized tax benefits</b>
Balance at January 1, 2012	\$ 5,219
Increases during the year:	
Gross increases – tax positions in prior period	988
Gross increases – current period tax positions	172
Decreases during the year:	
Gross decreases – tax positions in prior period	(165)
Decreases due to lapse of statute of limitations	(874)
Balance at December 31, 2012	\$ <u>5,340</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

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allocation of income among tax jurisdictions. During 2012, the Company settled three open tax years that were undergoing audits by state jurisdictions in which the Company operates. This allowed the Company to recognize tax benefits previously considered uncertain. The 2009 through 2011 federal income tax returns are the only open tax years that remain subject to potential future audit. The 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 2008 and, in certain states, income tax returns prior to 2009, 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 \$0.3 million to \$1.8 million (\$0.2 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.

The total projected benefit obligation of the Plan is \$184.2 million, of which \$158.4 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, 2012 is \$50.3 million, of which \$43.2 million is included in accrued pension and postretirement costs on the Company's consolidated balance sheet.

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 \$8.8 million are recorded on the consolidated balance sheet of WDR at December 31, 2012, of which \$8.2 million relates to the Company. Of the Company's total liability at December 31, 2012, \$0.3 million is included in other current liabilities, while the remainder is long term in nature and is included in accrued pension and postretirement costs.

**(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, 2012 were \$3.9 million.

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**(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, 2012. At December 31, 2012, the Company had net capital of \$24.7 million that was \$24.4 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, 2012 for which instructions to reduce to possession or control had been issued as of December 31, 2012, 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, 2012, excluding items arising from "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.

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**(11) 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):

2013	\$	19,596
2014		15,846
2015		12,346
2016		9,262
2017		6,923
Thereafter		21,577
	\$	<u>85,550</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 2012.

**(12) Related Parties**

The current amounts due from affiliates at December 31, 2012 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, 2012 include amounts due for administrative and other services.

The amount classified as income tax receivable at December 31, 2012 consists entirely of amounts due from WDR for tax allocations.

**(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.

The Company accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable, and the amount can be reasonably estimated. These amounts are not reduced by amounts that may be recovered under insurance or claims against third parties, but undiscounted receivables from insurers or other third parties may be accrued separately. The Company regularly revises such accruals in light of new information. For contingencies where an unfavorable outcome is reasonably possible and that are significant, the Company discloses the nature of the contingency and, where feasible, an estimate of the possible loss. For purposes of our litigation contingency disclosures, "significant" includes material matters as well as other items that management believes should be disclosed. Management judgment is required related to contingent liabilities and the outcome of litigation because both are difficult to predict.

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*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 Waddell & Reed, 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.

Subsequently, the Company moved for summary judgment on Plaintiffs' individual California claims. The Court issued an order on August 20, 2012 granting the Company's summary judgment motions, holding that Plaintiffs' individual California claims fail as a matter of law. This order effectively dismissed Plaintiffs from the case, both individually and as putative class representatives.

However, in its August 20, 2012 order, the Court also granted Plaintiffs' motion to add a new individual and putative class representative to the action, effectively replacing the originally named Plaintiffs. The newly named Plaintiff continued to pursue the California claims referenced above on behalf of the putative class, as well as newly added representative derivative claims under the California Private Attorney General Act.

The Company moved for summary judgment, asking the Court to dismiss the newly named Plaintiff's individual claims. The arguments made in support of this request were the same as those that prevailed in the Taylor and Young motions for summary judgment. On February 1, 2013, the Court issued an order granting the Company's summary judgment motion. This ruling effectively dismisses all remaining claims in the case in their entirety, pending appeal. No appeal has yet been filed. The Company intends to continue to vigorously defend the matter at appeal, if any.

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