

# Advisory Services

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Financial Planning

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## **COVER PAGE**

Waddell & Reed, Inc.  
SEC File Number: 16720  
Part 2A of Form ADV: Firm Brochure  
Financial Planning Services Brochure  
The date of this Brochure is: March 31, 2018

This brochure provides information about the qualifications and business practices of Waddell & Reed, Inc. in its capacity as an Investment Advisor. 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.

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

## SUMMARY OF CHANGES

Since our last ADV Part 2A filing, Waddell & Reed has updated this brochure to include information related to its managed account programs. Items that have been updated include:

1. Removed references to Waddell & Reed Advisors Funds as the reorganization with Ivy Funds has been completed.
2. Updated the Client Referrals and Other Compensation section with information regarding the revenue sharing disclosure document.
3. Updated the audited financial information.

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## ADVISORY BUSINESS

The following discussion presents an overview of Waddell & Reed, Inc. and generally discusses the Financial Planning and related products and services we offer and our corporate structure.

### ***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. Separate from the financial planning process, 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 publically held company (NYSE: WDR). Waddell & Reed provides competitive mutual fund offerings, including 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 Product Providers") among other insurance product carriers, and the Ivy InvestEd 529 Plan (collectively the Affiliated Mutual Funds"). As part of an organization that manages and offers the Affiliated Funds, Financial Advisors have direct access to portfolio managers and other professionals who are involved in analyzing and managing the Affiliated Mutual Funds on an ongoing basis. Therefore, Financial Advisors have the opportunity to know the Affiliated 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 the Firm's clients.

Of course, as needed or desired, Financial Advisors can offer mutual funds and other products that are not affiliated with Waddell & Reed. They may do so when the Affiliated Mutual Funds may not fully satisfy your investment goals or it may be in your best interests to consider other investment options consistent with your personal and financial goals. Waddell & Reed's 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 Affiliated 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**

Waddell & Reed believes that financial planning should be the cornerstone to a well-balanced investment program. That is why our Financial Advisors are trained to encourage clients at every stage of life to create a comprehensive financial plan before deciding to purchase investment products and how to allocate those products among various asset classes. To be effective, the financial planning process requires you and your Financial Advisor to each engage in the process in different ways.

#### **Your Financial Advisor will:**

- Conduct an initial consultation to assess and determine your personal financial concerns, priorities and goals.
- Evaluate the complexity of your financial situation and goals and work with you to determine the appropriate level of financial planning services necessary to meet your needs.
- Negotiate with you to determine and agree upon the appropriate fee (within pre-determined ranges) you will be charged to receive these agreed upon financial planning services.
- Review and analyze the information you provide to complete the financial planning services.
- Summarize your situation and develop specific strategies, solutions and/or actionable recommendations that will address your particular financial goals, concerns and investment needs in the form of a written financial plan that your Financial Advisor will provide to you either in a hard copy or electronic format.
- Schedule additional consultations as necessary to discuss your financial needs and goals.

#### **Financial Planning is an interactive process. To have the most success, you will need to:**

- Work with your Financial Advisor to determine the most appropriate financial goals to be evaluated and addressed during the term of the engagement.
- Identify any material life events, economic factors, changes in your financial situation, goals or any other issues that may cause a change in the advice given by your Financial Advisor and notify your Financial Advisor of such changes.

- Negotiate and agree upon the fee for your Financial Advisor's expertise and services. This fee is separate from any compensation you will pay or that your Financial Advisor may receive for or in connection with product sales and investment advisory programs, such as commissions and/or investment advisory fees.
- Understand the benefits of and limits to the financial planning process and form reasonable expectations with respect to the results to be obtained from your personal financial plan and recommended investment strategy.

Your Financial Advisor primarily relies on the information you provide to create your financial plan to ensure that the final plan and any recommendations contained in it are in your best interests. Therefore, the accuracy of the recommendations made by your Financial Advisor will depend directly on the accuracy of the information you provide with respect to your personal data, assets and liabilities, income and expenses, assumed overall expected rates of interest and inflation, short-term and long-term financial and personal goals, risk tolerance and other relevant information requested by your Financial Advisor. In addition to your personal information, your Financial Advisor may use, as necessary, financial planning publications and tools, training courses and materials, prospectuses and regulatory filings, financial information prepared by product sponsors and issuers, marketing material prepared by product sponsors, and product analyses prepared by third parties.

Your personal financial plan will assist in addressing your financial goals and objectives as you describe them to your Financial Advisor. Your financial goals and the potential strategies recommended to help meet your goals will be addressed in the context of your overall financial situation. Depending on the service(s) you select, your Financial Advisor will provide an analysis and summary of your current situation, compare it to your stated financial goals, offer appropriate strategies or alternatives, and make actionable recommendations to help you achieve your financial goals.

All investment illustrations included in your financial plan are hypothetical and do not reflect actual investment results or provide guarantees of future results. You are not obligated to implement any investment recommendations through your Financial Advisor or Waddell & Reed.

## **A. Financial Planning Services Offered:**

Depending upon your needs and the complexity of your financial situation you and your Financial Advisor will choose one of the Financial Planning Services described below to analyze and develop a financial plan specifically for you. The Financial Plan provided to you from this engagement will include a summary of your financial goal(s), net worth and may include a cash flow statement detailing your sources of income and your expenses.

### **1. Financial Planning Service**

The Financial Planning Service is an interactive and collaborative process to support you in accomplishing one or more of your financial goals. Together, you and your Financial Advisor will work through the financial planning process and these specific tasks to develop and create the appropriate plan and recommendations to address your stated financial goal(s):

- Initial Engagement: Discuss your specific financial goals and concerns, your current financial position and work with you to determine the appropriate level of service.
- Gather Data: Discuss your current financial position in more detail. This could include the need for you to provide documents such as account statements, tax returns, estate planning documents, and insurance contracts to your Financial Advisor. Your Financial Advisor and Waddell & Reed must rely on you to provide accurate and complete information about your financial situation.
- Analyze: Evaluate and analyze your current financial position based on the data and information you provide and begin to determine what actions will be needed to help you achieve your goals.
- Recommendations: Discuss recommendations to address your financial goals based on the analysis of the data and information provided.

### **2. Premier Financial Planning Service**

Reserved for advanced complexity cases, the Premier Financial Planning Service is a detailed, in-depth advanced financial planning service which includes the use of the resources and expertise of Waddell & Reed's Home Office Advanced Planning Department as a part of the interactive and collaborative financial planning process. Your Financial Advisor will work collaboratively with the Advanced Planning Staff to development of your financial plan and recommendations to address your stated financial goals.

Whether you choose the Financial Planning Service or the Premier Financial Planning Service, you will be provided a formal financial plan that includes a summary of your financial goals, net worth, and may include cash flow statements detailing sources of income and expenses. In addition, your financial plan will address one or more of the following goals:

- a. **Retirement:** Analyze projected retirement income and expenses based on defined retirement goals. The analysis may outline potential retirement shortages or surpluses and provides possible strategies to help meet your retirement capital and income needs.
- b. **Education Funding:** Analyze educational planning goals for specified education periods. The analysis may outline potential shortages or surpluses and provides possible strategies to help meet your educational goals.
- c. **Goal Funding:** Analyze specific financial goals. The analysis may outline potential shortages and surpluses and provides possible strategies to help meet any of your accumulation goals.
- d. **Survivor Income Needs:** Analyze the potential financial impact of death based on defined financial goals. The analysis may outline potential shortages or surpluses in the event of a death and provide strategies to help meet survivor income needs.
- e. **Disability Income:** Analyze the potential impact of a disability on defined financial goals over specified time periods.
- f. **Long-Term Care:** Analyze the potential impact of long-term care expenses on your financial situation.
- g. **Estate Planning:** Analyze your current estate and the effects of implementing various estate planning techniques and strategies such as wills, revocable trusts, irrevocable trusts and gifting programs.
- h. **Asset Allocation:** Offers basic asset allocation strategies for specific financial objectives based on individual time horizons and risk tolerance levels.
- i. **Business Planning:** Analyze the issues related to business continuity planning and the potential impacts they have on personal financial goals.
- j. **Income Tax Planning:** Address the estimated impact of taxes on your income, assets and financial goals including tax implications of various financial products. Waddell & Reed does not provide specific accounting or tax advice. Please consult your tax advisor for tax advice regarding your personal situation.

### 3. W&R Wealth Management Site

Waddell & Reed has contracted with a third-party whereby Waddell & Reed may offer clients a service known as the W&R Wealth Management Site. The W&R Wealth Management Site provides you a personal financial website that allows you to view and organize your financial accounts, track and monitor your net worth, expenses, liabilities, spending and budget.

In addition, you will have the ability to organize and maintain important documents and files by uploading them into a secure online document vault. This service can be included with any planning service listed above or offered as a stand-alone service at no additional charge and is offered to you by Waddell & Reed in its capacity as a Registered Investment Advisor.

In order to use the W&R Wealth Management Site, you will be provided a registration link via email, and be required to electronically review and accept the User Agreement and Terms of Service for the W&R Wealth Management Site. By accepting the User Agreement and Terms of Service electronically, you are also authorizing Waddell & Reed to deliver its Financial Planning Advisory Brochure to you in electronic format. The Wealth Management Site may be terminated at any time, without notice, by you, your Financial Advisor or Waddell & Reed. Termination will result in your login credentials being disabled. You will then no longer be able to access the W&R Wealth Management Site and retrieve stored documents and files. You should consider this when determining which documents and files you will place in the vault and whether other copies exist in other locations.

The consolidated view and reporting functionality available through the W&R Wealth Management Site is provided for informational purposes only and as a courtesy to you. These reports may include assets that Waddell & Reed does not hold on your behalf and which are not included on Waddell & Reed's books and records. While Waddell & Reed believes the information on the consolidated view and reporting functionality to be accurate, Waddell & Reed may not be the custodian of all of your assets, and therefore cannot be responsible for any inaccurate reporting of assets it does not custody. We urge you to compare these reports and the information reflected on the reports to the official account/policy statements provided by the custodians of your account/policy holdings to ensure that the information listed on these reports match the securities, insurance, cash, bank deposit and other holdings reflected on the official account statements provided by the custodians of your assets.

After your initial login to the W&R Wealth Management website, you are solely responsible for safeguarding your login credentials such as User Name and Password. You must immediately notify Waddell & Reed if your credentials are compromised. Waddell & Reed is not liable for any loss, claim, or other damages that result from unreported and/or unauthorized use of your login credentials.

## B. Financial Analysis Tools

The projections or other information generated by the financial planning software tools used by your Financial Advisor that include the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investments and are not guarantees of future results.

The financial planning service(s) you select may be prepared using one or more of the following tools:

## **1. Financial Planning Tools**

The financial planning service(s) you select may be implemented using financial planning software tools developed by Waddell & Reed or third parties.

## **2. Asset Allocation Tools**

Asset allocation tools may assist you in determining if you have an appropriate mix of investments for your personal situation. Development of a personalized asset allocation is designed to assist you in positioning your assets, based on your financial objectives, time horizons and risk tolerance. You may receive a report that contains hypothetical illustrations using assumed rates of return that are based on information you have provided to your Financial Advisor and from sources you deem to be reliable. Depicted rates of return are not representative of the actual rate of return that you will experience with any particular insurance or investment product. Such illustrations may be based on the concepts of 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.

Asset mixes in this analysis are derived using available historical information for each asset class based on the selected index for that class. They are meant only to illustrate the relative experience between asset classes and portfolios. Other asset classes and indices may have characteristics similar or superior to those being analyzed in any given scenario.

If you have a substantial percentage of your net worth concentrated in a given asset class, the asset allocation process may prompt your Financial Advisor to recommend that you sell a significant portion of that asset class in order to potentially reduce risk by reducing the concentrated positions within your portfolio. Before you actually sell any assets, it is very important that you consult with your legal and tax advisors regarding the tax and other implications of any such sale. There is a significant risk of adverse tax consequences if your transactions have not properly been evaluated by your legal and tax advisors. Your legal and tax advisors should ensure that any transactions have been properly structured to minimize tax effects. Neither Waddell & Reed nor your Financial Advisor, in his or her capacity as a registered representative or an investment advisor representative, provide the specialized, detailed legal or tax advice necessary to ensure that you avoid adverse tax consequences.

The optimal portfolio mix for a particular client is determined based on a variety of factors, including age, risk tolerance, goals and objectives, time horizon and historical performance of different asset classes. However, the analysis does not provide a comprehensive financial analysis of your ability to reach your goals, and it does not identify the impact of your investment strategy on your tax and estate planning situations. These components of financial planning are more appropriately handled by a comprehensive financial analysis. Generally, periodic rebalancing of your portfolio and re-optimization among the asset classes is recommended. Waddell & Reed does not provide discretionary money management services as part of its financial planning services.

## **3. Monte Carlo Engine**

Your Financial Advisor may use a tool with a Monte Carlo simulation engine. Monte Carlo engines are based on different assumptions that lead to varying probabilities of success among various investment scenarios. When interpreting your probability of success, it is important to review the underlying assumptions included in your financial plan, to determine if and how those assumptions may apply to your actual personal financial situation. The assumptions used to generate your personal financial plan are likely different than the assumptions found in other Monte Carlo simulations. As a result, you are likely to receive a substantially different simulation success rate when you use our Monte Carlo simulation engine. Additionally, the results you achieve using our Monte Carlo engine may vary with each subsequent use and over time. The probability of success may also vary from one planning period to the next due to your changing circumstances and updated market information. Results are hypothetical and reflect only one point in time. Therefore, we strongly recommend that you revisit your Monte Carlo simulation analysis at least annually to accommodate these changes and updates. The probability of success is only one factor to consider in financial planning. Other important factors include recommendations of your Financial Advisor and other professionals, your personal and financial goals and objectives, your investment risk tolerance, your desired lifestyle currently and in retirement and your needs for special protections, such as insurance or investment products intended to meet specific needs.

## **C. Other Advisory Services**

In addition to Financial Planning, Waddell & Reed offers fee-based asset allocation and wrap fee programs. These investment programs are tailored to your individual needs and allow your Financial Advisor to enter into a fee-based arrangement to manage your assets for you. These fee-based asset allocation and wrap fee programs are described in significant detail in separate advisory services brochures. Please ask your Financial Advisor for these advisory services brochures if you are interested in engaging in an investment advisory relationship wherein your Financial Advisor would actively manage your financial assets.



## FEES AND COMPENSATION

### Negotiable Fees:

Waddell & Reed is a registered investment advisor and its Financial Advisors are investment advisory representatives (IARs) of the firm. Both parties must adhere to a fiduciary duty and standard of care which requires that we place the interest of our clients ahead of our own interests when we engage our financial planning practice with you. As such, it is a common practice for advisors and clients to negotiate the specific fee for financial planning services.

Financial Planning fees are negotiable and are subject to acceptance by the client. Fees are based primarily on the service(s) chosen by you and the complexity of your unique financial situation. You and your Financial Advisor will determine your case complexity by completing the Complexity Worksheet which is a part of your Financial Planning Services Agreement. Your answers will create a score which will translate into a Basic, Intermediate or Advanced complexity rating.

Factors that influence and determine the case complexity for the Financial Planning Service or Premier Financial Planning service include:

1. Net worth
2. Investable assets
3. Household income
4. Sources of income
5. Current financial life stage
6. Total number of financial goals
7. Anticipated time your financial advisor expects to spend to complete the service

The fees charged may vary between clients, even those who have similar complexity, and from one financial advisor to another for various reasons. These reasons could include, but are not limited to:

- The specific circumstances within each client's situation
- The level of industry experience and designations of the advisor
- The geographic location of clients and advisors

The negotiated fee must not exceed the maximum fee for the complexity of the service provided, as set forth below:

Service	Maximum Fee
Financial Planning Service	
Basic Complexity	\$2,500
Intermediate Complexity	\$5,000
Advanced Complexity	\$10,000
Premier Financial Planning Service	\$15,000
The minimum fee for the Premier Financial Planning Service is \$3,000	

Under certain circumstances and only with prior approval from the Financial Advisors Division of the Waddell & Reed Home Office fees for advanced complexity cases may exceed \$15,000 for the Premier Financial Planning Service.

### Fee Payment

Fees for the Financial Planning Service, and the Premier Financial Planning Service are payable in full at the time you execute your Financial Planning Services Agreement. Your financial plan must be delivered and acknowledged through a signed delivery receipt no later than six (6) months from the date you execute your Financial Planning Services Agreement or such earlier date as you and your Financial Advisor agree. However, in certain circumstances, the Premier Financial Planning Service may require more than six (6) months to complete due to the complexity. In these situations your advisor will communicate with you the need for an extension of time before the original six month deadline is reached.

### Method of Payment and Refunds

Fees may be paid by personal or cashier's check payable to Waddell & Reed, Inc., credit card, or check issued from a direct non-qualified affiliated or unaffiliated mutual fund account or non-qualified Pershing account made payable to Waddell & Reed, Inc.

Checks may not be made payable to your Financial Advisor or to any entity other than Waddell & Reed. Redemptions may not be made from an investment account which would result in a contingent deferred sales charge (CDSC) or non-aged A shares (must be held for at least three (3) years). Redemptions from qualified retirement plans, IRAs or variable insurance sub-accounts are not permitted under any circumstances.

Payments made in advance for any services will be refunded in full to any client who enters into a Financial Planning Services Agreement but decides to terminate the Agreement prior to receipt of any services. Payment for services will be refunded in full to any client who is not fully satisfied with the financial planning services ultimately received, provided the client notifies Waddell & Reed in writing within sixty (60) days after receipt of all financial planning services purchased, but not later than one (1) year from the date the client signed the Financial Planning Services Agreement. As a condition to receiving a refund after all services are received, clients may be required to provide certain information to enable Waddell & Reed to determine the reasons for dissatisfaction. Waddell & Reed will also refund any payment made in advance for services not delivered to you within six (6) months from the date the client signed the Financial Planning Services Agreement. In some situations, and only with prior approval of Waddell & Reed's Home Office Financial Advisors Division, the six (6) month delivery requirement may be extended.

A Financial Planning Services Agreement may be terminated at any time by you or Waddell & Reed upon the date a written termination notice is received from you by Waddell & Reed or on the date such notice is sent by Waddell & Reed to you at your address shown on the Financial Planning Services Agreement being terminated. Additional information regarding fees is contained in the Financial Planning Services Agreement.

### **Fee Discounts, Free Services and Fee Changes**

Waddell & Reed may offer financial planning services free of charge or at a reduced fee for promotional and charitable purposes. Waddell & Reed may accept payment for the performance of financial planning services from persons other than the recipient of the services, through a referral arrangement or otherwise. Fees are subject to change.

### **Other Fees and Compensation**

If you implement our Financial Planning recommendations through your Financial Advisor by agreeing to purchase securities, insurance, or other financial products offered through Waddell & Reed, you will pay commissions, asset-based fees, internal expenses of certain products you select such as mutual funds and variable insurance products, and in some cases trust company or custodian fees if you invest through a retirement plan account such as an IRA, 457 or 403(b) plan account.

**Fee-based Products:** Waddell & Reed offers mutual fund asset allocation programs, details of which can be found in other Advisory Services Brochures obtained from your Financial Advisor. If you invest in one of these programs you will sign a different services agreement and pay an additional ongoing advisory fee for advice concerning the investment of your assets in one or more of these programs. Advisory fees charged in these programs are separate from, and in addition to, your financial planning fee. It is possible that you will pay a financial planning fee for a financial plan that, among other things, recommends the use of more than one fee-based program. In case you decide to invest in a fee-based program you will pay fees for participating in each of these programs.

Financial Advisors may recommend the Affiliated Mutual Funds. The Affiliated Mutual Funds your Financial Advisor recommends may charge front-end commissions or a back-end CDSC. The investment managers who manage these mutual funds and Financial Advisors are part of the same parent organization – Waddell & Reed Financial, Inc. Throughout more than 80 years of serving investors, Waddell & Reed has developed a business structure that combines both the creation and management of the Affiliated Mutual Funds and their sale to retail investors through Waddell & Reed in its capacity as a registered investment advisor and/or broker-dealer and its Financial Advisors. We believe this business structure provides significant value to our clients, but also presents certain conflicts, which are discussed more fully below.

Higher revenue received from the sale of the Affiliated Mutual Funds generally results in greater profitability for Waddell & Reed and its affiliates. Employee compensation (including management and field leader compensation) and operating goals at all levels of the company are tied to varying degrees of Waddell & Reed's financial success. As such, management, sales leaders and other employees generally spend more of their time and resources promoting the Affiliated Mutual Funds and related products and services.

Both Waddell & Reed and your Financial Advisor are compensated when you buy mutual funds and variable insurance products through Waddell & Reed. When investing outside of a fee-based product, your Financial Advisor receives a substantial portion of the sales charge and distribution and shareholder service (12b-1) fees paid 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 will 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 Waddell & Reed investment accounts.

Operating expenses include: fees paid for investment management (research, trading, portfolio manager compensation, administrative services and technology), distribution and shareholder services 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. For non-fee based products, a significant portion of the distribution and service fees will be paid to your Financial Advisor as additional compensation on an ongoing basis.

For additional information, you should review carefully the prospectus and, where applicable, statement of additional information for the particular mutual fund you are considering. The fact that your Financial Advisor may recommend the purchase of the Affiliated Mutual Funds presents a conflict of interest and gives your Financial Advisor an incentive to recommend these products. Other investment alternatives having similar or better risk and return characteristics and lower costs may be available to you. Before purchasing investment products from your Financial Advisor you should consider that most of Waddell & Reed's revenue is generated from the sale of mutual funds and variable insurance products that charge commissions. Typically, this commission revenue is generated by the sale of the Affiliated Mutual Funds. If you wish to purchase securities in a brokerage account through your Financial Advisor, you will be required to open a brokerage account at Pershing LLC. Waddell & Reed clears its general securities business exclusively through Pershing LLC on a fully disclosed basis. You will incur certain fees, expenses and trading costs if you conduct your Waddell & Reed brokerage business through a brokerage account maintained at Pershing LLC. You will receive a list of these fees, expenses and trading costs when you establish your Waddell & Reed brokerage account.

## **PERFORMANCE-BASED FEES AND SIDE-BY-SIDE MANAGEMENT**

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

## **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

## **METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS**

Waddell & Reed typically recommends as part of its overall financial planning process that clients broadly allocate their assets among a number of common asset classes. The financial plans we create contain general asset allocation recommendations. Nevertheless, Financial Advisors, if requested by our clients, may recommend specific investment and insurance products to implement the asset class allocation developed through the financial plan. If you choose to implement any specific recommendation for the purchase/sale/exchange of securities, advisory programs and/or insurance products, you will complete additional documentation outside of the financial planning process and may be charged a sales charge, ongoing investment advisor fee or other charge/fee for those transactions. Clients should consider that asset allocation alone cannot ensure gains in up markets or protect accounts against loss in down markets. As discussed above, Financial Advisors generally recommend the Affiliated Mutual Funds. We believe that these securities do not involve significant or unusual risks to our clients.

## **DISCIPLINARY INFORMATION**

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 program 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 & Reed agreed to a censure and fine of \$75,000 to settle the regulatory action.

On June 19, 2015 the State of New Hampshire, Department of State, Bureau of Securities (the "Bureau") received a complaint from a New Hampshire resident and former client of Waddell, which raised concerns regarding certain financial planning fees charged by an investment advisor representative of Waddell. Based on the content of the complaint, the Bureau initiated an investigation. During the course of its investigation, the Bureau determined that the investment advisor representative in question engaged in several violations of New Hampshire securities law, including verbally misrepresenting to his clients the nature of financial planning fees he charged those clients. The Bureau also noted certain deficiencies in Waddell's supervision of the investment advisor representative in question. The Bureau noted that over the past two years, Waddell has taken steps to enhance its supervision of the financial planning conducted by its investment advisor representatives and these enhancements will be finalized during the second quarter of 2017. All of the Bureau's allegations against Waddell are limited to investment advisory activities.

Pursuant to Waddell's Financial Planning Refund Program, Waddell agreed to refund a portion of certain financial planning fees paid by the clients of the investment advisor representative in question, in the amount of \$2,012,615.80. Waddell also agreed to pay the Bureau's costs of investigation in the amount of \$300,000, an administrative fine in the amount of \$300,000, and a contribution to the Bureau's investor education fund in the amount of \$300,000.

## OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

Waddell & Reed is registered as a broker-dealer and a federally registered investment advisor (a "RIA"). Your Financial Advisor is both an investment advisor representative ("IAR") and a registered representative of the broker dealer, Waddell & Reed, Inc. As such, your Financial Advisor may offer our financial planning services, various fee-based asset allocations and wrap programs, some of which are sponsored by Waddell & Reed and general securities products including:

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

Waddell & Reed has material relationships and arrangements with the following:

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

**Affiliated Mutual Funds.** Please read carefully the discussion above under "Other Fees and Compensation" regarding the conflicts of interest inherent in the relationship between Waddell & Reed and the Affiliated Mutual Funds. Also, the investment managers for the Affiliated Mutual Funds are 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 Product Providers.

**Strategic Product Providers.** We discuss our relationship with the Strategic Product Providers under Advisory Business, Overview and Ownership above. Most of the variable insurance products we sell are created by our Strategic Product Providers. 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.

**Lockwood Advisors, Inc.** Lockwood Advisors, Inc. is an affiliate of Pershing LLC. Waddell & Reed uses Lockwood Advisors, Inc. as a platform for several of the fee-based asset allocation and wrap programs we offer as an investment advisor. Waddell & Reed pays various fees to Lockwood Advisors, Inc. for its services. Waddell & Reed offers its investment advisory clients SMA and UMA products sponsored and/or managed by Lockwood Advisors, Inc. Waddell & Reed receives a portion of the fees charged to clients by the managers of these products. See Appendix I to Form ADV Part 2 for more information about this relationship.

## 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  
Overland Park, KS 66202-4247

## BROKERAGE PRACTICES

Waddell & Reed does not receive research or soft dollar benefits from any broker-dealer in connection with client securities transactions.

Clients that decide to purchase securities in connection with their financial planning experience with Waddell & Reed need not purchase securities through Waddell & Reed or its Financial Advisors. They may purchase these securities through any broker-dealer or through fee-based accounts at any Investment Advisor. Nevertheless, clients that decide to purchase securities in brokerage accounts through Waddell & Reed must do so only through brokerage accounts carried for Waddell & Reed by Pershing LLC. All transactions effected in these brokerage accounts will be executed by Pershing LLC. By directing brokerage executions through Pershing LLC, we may be unable to achieve most favorable execution for your transactions and it may cost more to execute transactions through Pershing LLC than through other broker-dealers. Nevertheless, Waddell & Reed continually monitors the quality of executions in accounts held at Pershing LLC. We believe Pershing LLC provides highly competitive execution quality based on (i) speed and certainty; (ii) price improvement; and (iii) overall execution quality.

## REVIEW OF FINANCIAL PLANNING AGREEMENTS

All Financial Planning Service Agreements for a fee are reviewed by a supervisory principal of Waddell & Reed to ensure that the services selected meet the individual client’s stated personal financial situation, life stage, investment and financial objectives.

## **CLIENT REFERRALS AND OTHER COMPENSATION**

Waddell & Reed has a financial interest in our clients' transactions and the recommendations we make to clients to buy or sell securities or investment products. Waddell & Reed has revenue sharing arrangements with certain available product companies outside of advisory programs. 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 financial advisors ("affiliated persons"), these arrangements could affect the judgment of Waddell & Reed or its affiliated persons when recommending investment products. We believe the potential conflicts of interest that are created by these revenue sharing agreements are addressed through internal policies to prevent Waddell & Reed, in its capacity as investment adviser, and any affiliated person, from considering existing business relationships when selecting or recommending investment products.

Waddell & Reed has additional policies and procedures, including client disclosures, to address this conflict. For more information regarding revenue sharing, please visit [www.waddell.com/disclosures-privacy/client-disclosures](http://www.waddell.com/disclosures-privacy/client-disclosures) or request a revenue sharing disclosure document from your financial advisor.

## **CUSTODY**

You will receive statements reflecting your investment account holdings on a quarterly or monthly basis depending on where your accounts are held. In addition, you may receive statements more frequently if you have transactions in your accounts. You will receive confirmations and statements from our transfer agency if your purchase, sell, or hold the Waddell & Reed Mutual Funds direct with our transfer agency. You will receive confirmations and statements from the product sponsor if you hold other mutual funds direct at the fund or variable insurance products direct at the carrier. You will receive confirmations and monthly statements from Pershing LLC if you purchase, sell, or hold securities in a brokerage account. Your Financial Advisor is permitted to provide reports that may include lists or summaries of account holdings, including funds and securities. However, these are merely unofficial account summaries and must not be relied upon as an accurate, complete statement of your account holdings or activity.

## **INVESTMENT DISCRETION**

We typically 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. Certain Financial Advisors, who meet specific qualifications regarding training, education and experience, are granted the ability to use discretionary authority within the MAPFlex and MAPLatitude programs. This takes place when certain client situations have the need for or specifically request their advisor to manage their account in this manner. Each client must review and sign a discretionary authorization form granting the advisor this authority.

## **VOTING CLIENT SECURITIES**

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

## **FINANCIAL INFORMATION**

A copy of Waddell & Reed's Consolidated Balance Sheet is included.

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**WADDELL & REED, INC. AND SUBSIDIARIES**  
(An Indirect Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)  
Consolidated Balance Sheet  
December 31, 2017  
(With Report of Independent Registered Public Accounting Firm Thereon)





KPMG LLP  
Suite 1100  
1000 Walnut Street  
Kansas City, MO 64106-2162

## Report of Independent Registered Public Accounting Firm

The Board of Directors  
Waddell & Reed, Inc.:

### *Opinion on the Consolidated Financial Statement*

We have audited the accompanying consolidated balance sheet of Waddell & Reed, Inc. and subsidiaries (the Company) as of December 31, 2017, and the related notes (collectively, the consolidated financial statement). In our opinion, the consolidated financial statement presents fairly, in all material respects, the financial position of the Company as of December 31, 2017, in conformity with U.S. generally accepted accounting principles.

### *Change in Accounting Principle*

As discussed in Note 1 to the financial statements, the Company has elected to change its method of accounting for net periodic pension cost to immediately recognize actuarial gains and losses in net periodic pension cost in the year in which the gains and losses occur.

### *Basis for Opinion*

This consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statement is free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the consolidated financial statement, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statement. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statement. We believe that our audit provides a reasonable basis for our opinion.

**KPMG LLP**

We have served as the Company's auditor since 1981.

Kansas City, Missouri  
March 8, 2018

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

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

Consolidated Balance Sheet

December 31, 2017

(In thousands)

**Assets**

Cash and cash equivalents	\$ 117,712
Cash and cash equivalents – restricted	28,156
Investment securities	111,790
Receivables:	
Funds and separate accounts	18,069
Customers and other	96,082
Due from affiliates	17,731
Prepaid expenses and other current assets	21,435
Income taxes receivable	5,653
Total current assets	416,628
Property and equipment, net	83,486
Deferred income taxes	13,350
Goodwill and identifiable intangible asset	35,095
Other non-current assets	14,803
Total assets	\$ 563,362

**Liabilities and Stockholder's Equity**

Accounts payable	\$ 15,199
Payable to investment companies for securities	43,422
Payable to third party brokers	7,030
Payable to customers	66,830
Accrued compensation	35,708
Due to affiliates	2,903
Other current liabilities	13,620
Total current liabilities	184,712
Accrued pension and postretirement costs	13,613
Other non-current liabilities	19,718
Total liabilities	218,043
Commitments and contingencies	
Redeemable noncontrolling interests	2,626
Stockholder's equity:	
Common stock, \$1.00 par value: 1,000 shares authorized, issued and outstanding	1
Additional paid-in capital	247,237
Retained earnings	95,076
Accumulated other comprehensive loss	379
Total stockholder's equity	342,693
Total liabilities, redeemable noncontrolling interests and stockholder's equity	\$ 563,362

See accompanying notes to consolidated balance sheet.

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

Notes to Consolidated Balance Sheet

December 31, 2017

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

**(a) Organization**

Waddell & Reed, Inc. (W&R Inc.), a broker-dealer and investment adviser, 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 group of mutual funds (the Advisors Funds), and InvestEd Portfolios (InvestEd) (collectively, the Funds), and institutional and separately managed accounts. The Company also derives revenues from investment product distribution and shareholder services administration provided to the Ivy Funds and Ivy Variable Insurance Portfolios (Ivy VIP), which are underwritten by an affiliate. In 2016, the Company was replaced by an affiliate as principal underwriter and distributor for Ivy VIP. The Funds, Ivy Funds, Ivy VIP 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. 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 our revenues and results of operations. The Company is an indirect wholly owned subsidiary of Waddell & Reed Financial, Inc. (WDR), a publicly traded company.

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 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, Ivy Funds and Ivy VIP, including commissions and other compensation paid to independent 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, Ivy Funds and Ivy VIP 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.

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2017

**(b) Basis of Presentation**

The accompanying consolidated balance sheet are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions have been eliminated in consolidation. Amounts in the accompanying balance sheet and notes are rounded to the nearest thousand unless otherwise stated. Also, refer to the “Pension Plan” section below regarding a change in method of accounting.

The company has evaluated subsequent events through February 23, 2018, the date that this balance sheet was issued and determined there are no other items to disclose.

Effective January 1, 2017, the Company adopted Accounting Standards Update (“ASU”) 2016-09, “*Improvements to Employee Share-Based Payment Accounting*.” This ASU requires excess tax benefits and tax shortfalls be recognized as income tax benefit or expense in the income statement on a prospective basis. Additionally, excess tax benefits or shortfalls recognized on share-based compensation are classified as an operating activity in the statement of cash flows. This ASU allows entities to withhold shares issued during the settlement of a stock award or option, as means of meeting minimum tax withholding due by the employee, in an amount up to the employees’ maximum individual tax rate in the relevant jurisdiction without resulting in a liability classification of the award (versus an equity classification). The value of the withheld shares is then remitted by the Company in cash to the taxing authorities on the employees’ behalf. The Company’s historical policy to withhold shares equivalent to the minimum individual tax rate is consistent with the thresholds meeting the classification of an equity award. This ASU requires that all cash payments made to taxing authorities on the employees’ behalf for withheld shares be presented as financing activities on the statement of cash flows. This ASU also allows for the option to account for forfeitures as they occur when determining the amount of share-based compensation expense to be recognized, rather than estimating expected forfeitures over the course of a vesting period. The Company elected to account for forfeitures as they occur. The net cumulative effect to the Company from the adoption of this ASU was a reduction to retained earnings of \$2.5 million and an increase to the non-current deferred tax asset of \$1.5 million as of January 1, 2017.

*Pension Plan*

During 2017, the Company retrospectively changed its method of accounting for net periodic pension cost. Historically, net actuarial gains or losses in excess of 10% of the greater of the market-related value of plan assets or the plan’s projected benefit obligation (the corridor) were amortized into operating expenses over the remaining working life of active plan participants. Unrecognized actuarial gains or losses were reflected as a component of stockholders’ equity in our consolidated balance sheets. Under the Company’s new method of accounting, the Company elected to immediately recognize all actuarial gains and losses in net periodic pension cost in the year in which the gains and losses occur noting that it is generally preferable to accelerate the recognition of gains

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2017

and losses into income rather than to delay such recognition. This change is intended to improve the transparency of the Company's underlying financial performance by recognizing the effects of current economic and interest rate trends on assumptions used to measure plan obligations and assets. These gains and losses are generally only measured annually as of December 31. Financial data for the period presented has been adjusted to reflect the effect of this accounting change.

The cumulative effect of the change on retained earnings as of January 1, 2017 was a decrease of \$42.4 million, with the corresponding adjustment to accumulated other comprehensive loss. The effects of the change in accounting on our balance sheet for the period presented were as follows:

		<b>As of December 31, 2017</b>	
		<b>Historical</b>	
		<b>Accounting</b>	<b>As</b>
		<b>Method</b>	<b>Adjusted</b>
<b>Balance Sheet Information:</b>			
Retained earnings	\$	126,264	95,076
Accumulated other comprehensive (loss) income		(30,809)	379

**(c) Consolidation**

In the normal course of our business, we sponsor and manage various types of investment products. These investment products include open-end mutual funds, a closed-end mutual fund, privately offered funds, exchange-traded managed funds, and the Ivy Global Investors Société d'Investissement à Capital Variable ("SICAV"). When creating and launching a new investment product, we typically fund the initial cash investment, commonly referred to as "seeding," so that the investment product can generate an investment performance track record so that it is able to attract third party investors in the product. Our initial investment in a new product typically represents 100% of the ownership in that product. We generally redeem our investment in seeded products when the related product establishes a sufficient track record, when third party investments in the related product are sufficient to sustain the strategy, or when a decision is made to no longer pursue the strategy. The length of time we hold a majority interest in a product varies based on a number of factors, including market demand, market conditions and investment performance. Our exposure to risk in these investment products is generally limited to any equity investment we have and any earned but uncollected management or other fund-related service fees.

In accordance with financial accounting standards, we consolidate certain sponsored investment products in which we have a controlling interest or the investment product meets the criteria of a Variable Interest Entity ("VIE") and we are deemed to be the primary beneficiary. In order to make this determination, an analysis is performed to determine if the investment product is a VIE or a Voting Interest Entity ("VOE"). Assessing if an entity is a VIE or VOE involves judgment and analysis on an entity by entity basis. Factors included in this assessment include the legal

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2017

organization of the entity, the Company's contractual involvement with the entity and any implications resulting from or associated with related parties' involvement with the entity.

A VIE is an entity which does not have adequate equity to finance its activities without subordinated financial support, the equity investors do not have the normal characteristics of equity investors for a potential controlling financial interest as a group, or the voting rights are not proportional to their obligations to absorb the expected losses or their rights to receive the expected residual returns of the entity. The Company is deemed to be the primary beneficiary if it absorbs a majority of the VIE's expected losses, expected residual returns, or both. If the Company is the primary beneficiary of a VIE, we are required to consolidate the assets, liabilities and equity of the VIE into our consolidated balance sheet.

If an entity does not meet the criteria and is not considered a VIE, it is treated as a VOE, which is subject to traditional consolidation concepts based on ownership rights. Sponsored investments products that are considered VOEs are consolidated if we have a controlling financial interest in the entity absent substantive investor rights to replace the investment manager of the entity (kick-out rights).

**(d) 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. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. Actual results could differ from those estimates.

**(e) Cash and Cash Equivalents**

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

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

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 for investment securities are based on Level 2 or Level 3 inputs detailed in Note 3.

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2017

**(g) *Investment Securities and Investments in Funds***

Our investments are comprised of debt and equity securities, investments in sponsored funds, and investments in sponsored privately offered funds (“LLCs”). Sponsored funds, which include the Funds, Ivy Funds, the Ivy Global Investors sub-funds (“IGI Funds”) and the LLCs, are investments we have made for both general corporate investment purposes and to provide seed capital for new investment products. The Company has classified its investments in certain sponsored funds as equity method investments (when the Company owns between 20% and 50% of the fund). Investments held with less than a 20% ownership interest are classified as trading.

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 sponsored funds. For sponsored funds, realized gains and losses are computed using the average cost method.

**(h) *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; one to five years for data processing equipment; one to 30 years for buildings; two to 26 years for other equipment; and up to 15 years for leasehold improvements, which is the lesser of the lease term or expected life.

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

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with ASC 350, “Intangibles – Goodwill and Other Topic.” Internal costs capitalized are included in property and equipment, net in the consolidated balance sheet, and were \$9.7 million as of December 31, 2017. Amortization begins when the project is complete and ready for its intended use and continues over the estimated useful life, generally one to 10 years.

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

Goodwill represents the excess of cost over fair value of the identifiable net assets of acquired companies. Indefinite-lived intangible asset represent advisory management contract for managed assets obtained in acquisitions. The Company considers this contract to be indefinite-lived intangible asset as it’s expected to be renewed without significant cost or modification of terms. Goodwill and indefinite-lived intangible assets are tested for impairment annually or more frequently if events or circumstances indicate that the carrying value may not be recoverable. Goodwill and intangible assets require significant management estimates and judgment, including the valuation determination in connection with the initial purchase price allocation and the ongoing evaluation for impairment. Additional information related to the indefinite-lived intangible assets is included in

(Continued)



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

Notes to Consolidated Balance Sheet

December 31, 2017

Note 4. To determine the fair value of the Company's 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 publicly-traded companies in the financial services industry. Estimates of fair values of the reporting units are established using multiples of earnings before interest, taxes, depreciation and amortization ("EBITDA"). The Company believes that fair values calculated based on multiples of EBITDA are an accurate estimation of fair value.

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

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

**(k) Revenue Recognition**

*Investment Management and Advisory Fees*

We recognize investment management fees as earned over the period in which services are rendered. We charge the Funds daily based upon average daily net assets under management in accordance with investment management agreements between the Funds and the Company. In the fourth quarter of 2017, nine Advisors Funds merged into Ivy Funds with substantially similar objectives and strategies. The Company has received the necessary approvals from the mutual fund Board of Trustees to merge the remaining Advisor Funds into Ivy Funds in February of 2018. The majority of investment and/or advisory fees earned from institutional and separate accounts are charged either monthly or quarterly based upon an average of net assets under management in accordance with such investment management agreements. The Company may waive certain fees for investment management services at its discretion, or in accordance with contractual expense limitations, and these waivers are reflected as a reduction to investment management fees on the consolidated statement of income. Through revenue sharing allocation agreements with affiliates, the Company also receives 10 basis points on gross sales of assets and 10 basis points on average assets under management for separately managed account relationships established by the institutional channel.

Our investment advisory business receives research products and services from broker/dealers through "soft dollar" arrangements. Consistent with the "soft dollar" safe harbor established by

(Continued)



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

Notes to Consolidated Balance Sheet

December 31, 2017

Section 28(e) of the Securities Exchange Act of 1934, as amended, the investment advisory business does not have any contractual obligation requiring it to pay for research products and services obtained through soft dollar arrangements with brokers. As a result, we present “soft dollar” arrangements on a net basis.

The Company has contractual arrangements with third parties to provide subadvisory services. Investment advisory fees are recorded gross of any subadvisory payments and are included in investment management fees based on management’s determination that the Company is acting in the capacity of principal service provider with respect to its relationship with the Funds and Ivy VIP. Any corresponding fees paid to subadvisors are included in operating expenses.

*Distribution, Underwriter and Service Fees*

Underwriting and distribution commission revenues resulting from the sale of investment products are recognized on the trade date. When a client purchases Class A or Class E shares (front-end load), the client pays an initial sales charge of up to 5.75% of the amount invested. The sales charge for Class A or Class E shares typically declines as the investment amount increases. In addition, investors may combine their purchases of all fund shares to qualify for a reduced sales charge. When a client invests in a fee-based asset allocation product, Class I or Y shares are purchased at net asset value and we do not charge an initial sales charge.

Under a Rule 12b-1 service plan, the Funds may charge a maximum fee of 0.25% of the average daily net assets under management for Class B and C shares for expenses paid to broker/dealers and other sales professionals in connection with providing ongoing services to the Funds’ shareholders and/or maintaining the Funds’ shareholder accounts, with the exception of Class Y shares, which do not charge a service fee. The Funds’ Class B and Class C shares may charge a maximum of 0.75% of the average daily net assets under management under a Rule 12b-1 distribution plan to compensate broker/dealers and other sales professionals for their services in connection with distributing shares of that class. The Fund’s Class A shares may also charge a maximum fee of 0.25% of the average daily net assets under management under a Rule 12b-1 service and distribution plan for expenses detailed previously. The Company receives 12b-1 fees for Ivy Funds sold by independent financial advisors associated with the Company. The Rule 12b-1 plans are subject to annual approval by the Funds’ board of trustees, including a majority of the disinterested members, by votes cast in person at a meeting called for the purpose of voting on such approval. All Funds may terminate the service and distribution plans at any time with approval of fund trustees or portfolio shareholders (a majority of either) without penalty.

Fee-based asset allocation revenues are charged quarterly based upon average daily net assets under management. For certain types of investment products, primarily variable annuities, distribution revenues are generally calculated based upon average daily net assets under management and are recognized monthly. Fees collected from independent advisors associated with the Company for

(Continued)

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

Notes to Consolidated Balance Sheet

December 31, 2017

technology and other various services are recorded in underwriting and distribution fees on a gross basis, as the Company is the primary obligor in these arrangements.

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 by independent financial advisors associated with the Company. In addition, the Company receives revenue for providing accounting, information technology, legal, marketing, rent and other administrative services to affiliated companies.

**(l) Leases**

The Company leases office space under various leasing arrangements. Most lease agreements contain renewal options, rent escalation clauses and/or other inducements provided by the landlord. Rent expense is recorded on a straight-line basis, including escalations and inducements, over the term of the lease.

**(m) 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 ASC 740, "Income Taxes." 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 to reduce 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 liabilities are measured using enacted tax rates that will be in effect when they are expected to be realized or settled. The effect on the measurement of deferred tax assets and liabilities of a change in income tax law is recognized in earnings in the period that includes the enactment date.

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Reform Act") was enacted, which significantly revised the U.S. Corporate income tax system by, among other things, permanently

(Continued)

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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reducing the federal statutory tax rate from 35% to 21% effective January 1, 2018. The Company recorded a charge of \$5.4 million in the 4th quarter of 2017 to measure our net deferred tax assets at the reduced federal statutory rate. The SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”) to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Reform Act. The Company has recognized the provisional tax impact related to the revaluation of deferred tax assets and liabilities and included these amounts in its consolidated balance sheet for the year ended December 31, 2017. The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Reform Act. The accounting is expected to be complete when the 2017 U.S. corporate income tax return is filed in 2018.

**(2) New Accounting Guidance**

*New Accounting Guidance Adopted*

On January 1, 2017, the Company adopted ASU 2016-09. See Note 1 – Summary of Significant Accounting Policies – Basis of Presentation for a description of the ASU and the financial statement impact of adopting this ASU.

*New Accounting Guidance Not Yet Adopted*

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This standard also specifies the accounting for certain costs to obtain or fulfill a contract with a customer. This ASU will supersede much of the existing revenue recognition guidance in accounting principles generally accepted in the United States and is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period; early application is permitted for the first interim period within annual reporting periods beginning after December 15, 2016. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. Upon adoption, the Company will utilize the cumulative effect approach. We have evaluated our population of contracts and did not identify any material changes in our current revenue recognition practices and concluded that the adoption of this ASU will have an immaterial impact on our consolidated balance sheet. Upon adoption of the amendments in this ASU, the Company will add qualitative and quantitative information to the notes to its consolidated balance sheet related to contracts with customers, including revenue and impairments recognized, disaggregation of revenue, information about contract balances and performance obligations; significant judgments and changes in judgments about determining the timing of satisfaction of performance obligations and determining the transaction price and amounts allocated to performance obligations; and assets recognized from the costs to obtain or fulfill a contract.

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In February 2016, FASB issued ASU 2016-02, *“Leases,”* which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU will be presented using a modified retrospective approach, which includes a number of optional practical expedients that entities may elect to apply. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. Although the Company is evaluating the estimated impact the adoption of this ASU will have on our consolidated balance sheet and related disclosures, the Company currently believes the most significant changes will be related to the recognition of new right-of-use assets and lease liabilities on the Company’s consolidated balance sheet for real estate operating leases.

In March 2017, FASB issued ASU 2017-04, *“Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment.”* This ASU eliminates the second step from the goodwill impairment test. An entity should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity will recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value, but the loss cannot exceed the total amount of goodwill allocated to the reporting unit. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. We have concluded that the adoption of this ASU will have an immaterial impact on our consolidated balance sheet and related disclosures.

In March 2017, FASB issued ASU 2017-07, *“Compensation-Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.”* This ASU changes the income statement presentation of defined benefit plan expense by requiring separation between operating expense (service cost component) and non-operating expense (all other components, including interest cost, amortization of prior service cost, curtailments and settlements, etc.). The operating expense component is reported with similar compensation costs while the non-operating components are reported in a separate line item outside of operating items. In addition, only the service cost component is eligible for capitalization as part of an asset. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. We have concluded that the adoption of this ASU will have no effect on our net income because it only impacts the classification of certain information on the consolidated statement of income. The service cost component of net periodic benefit cost was recognized in underwriting and distribution, and compensation and related costs through September 30, 2017. An amendment to freeze our noncontributory retirement plan that covers substantially all employees and certain vested employees of our former parent company (the “Pension Plan”) was approved effective September 30, 2017; therefore, after September 30, 2017 we no longer incur service cost. The other components of net periodic cost will be classified in investment and other income.

In May 2017, FASB issued ASU 2017-09, *“Compensation-Stock Compensation: Scope of Modification Accounting.”* This ASU provides guidance about which changes to the terms or

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conditions of a share-based payment award require an entity to apply modification accounting in Topic 718, “*Compensation – Stock Compensation*.” This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. We have concluded that the adoption of this ASU will have an immaterial impact on our consolidated balance sheet and related disclosures.

**(3) Investment Securities**

Investments at December 31, 2017 are as follows (in thousands):

Trading securities:

Certificates of deposit	1,000
Common stock	116
Consolidated sponsored funds	74,645
Corporate bonds	32,213
Mortgage-backed securities	10
Sponsored funds	154
Sponsored privately offered funds	695
U.S. Treasury bills	2,957

Total investment securities	\$ <u>111,790</u>
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*Sponsored funds*

The Company has classified its investments in certain sponsored funds as trading securities when the Company owns less than 20% of the fund. Sponsored funds in which we hold a majority interest are consolidated in our balance sheet. Sub-funds of the IGI SICAV have been consolidated in our financials as of December 31, 2017.

*Sponsored privately offered funds*

The Company holds voting interests in certain sponsored privately offered funds that are structured as investment companies in the legal form of LLCs. During 2017, \$3.9 million of investment in one of the sponsored privately offered funds was consolidated in the balance sheet. Previously, this investment was accounted for under the equity method. A plan to dissolve this fund was initiated in 2017. All of the underlying investment securities held by the fund were sold and the ratable portion of the cash proceeds was distributed to the noncontrolling member before December 31, 2017. As of December 31, 2017, the fund held cash of \$4.2 million, which was distributed to the Company in January 2018.

Also during 2017, \$0.6 million of investments in two sponsored privately offered funds were reclassified from available-for-sale securities to trading securities. One of these funds was dissolved in 2017. As of

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December 31, 2017, the fair value of the Company's investment in the remaining privately offered fund was \$0.7 million.

The total investment in sponsored privately offered funds of \$4.9 million is our maximum loss exposure on these investments.

*Maturities of Fixed Income Securities*

Certificate of deposit, U.S. Treasury bills, Corporate bonds, and Mortgage-backed securities accounted for as trading and held as of December 31, 2017 mature as follows:

	<u>Fair Value</u>
Within one year	\$ 6,032
After one year but within five years	25,148
After 10 years	<u>5,000</u>
	<u>\$ 36,180</u>

*Consolidated Sponsored and Sponsored Privately Offered Funds*

The following table details the balances related to consolidated sponsored funds at December 31, 2017, as well as the Company's net interest in these funds:

Cash	\$ 7,556
Investments	74,645
Other assets	946
Other liabilities	(838)
Redeemable noncontrolling interests	<u>(2,626)</u>
Net interest in consolidated sponsored funds	<u>\$ 79,683</u>

During 2017, we consolidated a sponsored privately offered fund in which we provided initial capital at the time of the fund's formation. When we no longer have a controlling financial interest in a sponsored fund, it is deconsolidated from our balance sheet.

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:

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- 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 carrying amounts of certificates of deposits are measured at amortized cost, which approximates fair value due to the short-time between purchase and expected maturity of the investments. Depending on the nature of the inputs, these investments are generally classified as Level 1 or 2 within the fair value hierarchy. U.S. Treasury bills are valued upon quoted market prices for similar assets in active markets, quoted prices for identical or similar assets that are not active and inputs other than quoted prices that are observable or corroborated by observable market data. 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. The fair value of equity derivatives is measured based on active market broker quotes, evaluated broker quotes and evaluated prices from vendors.

The following table summarizes our investment securities as of December 31, 2017 that are recognized in our consolidated balance sheet using fair value measurements based on the differing levels of inputs.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(In thousands)			
<b>Trading Securities:</b>				
Certificate of deposit	—	1,000	—	1,000
Common stock	116	—	—	116
Consolidated sponsored funds	49,538	25,107	—	74,645
Corporate bonds	—	32,213	—	32,213
Mortgage-backed securities	—	10	—	10
Sponsored funds	154	—	—	154
Sponsored privately offered funds measured at net asset value (1)	—	—	—	695
U.S. Treasury bills	—	2,957	—	2,957
Total	<u>\$ 49,808</u>	<u>61,287</u>	<u>—</u>	<u>111,790</u>

- (1) Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheet.

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

Goodwill represents the excess of purchase price over the tangible assets and the identifiable intangible asset of the acquired business. Our goodwill is not deductible for tax purposes. Goodwill and the identifiable intangible asset (all considered indefinite-lived) at December 31, 2017 are as follows (in thousands):

Goodwill	\$ 8,242
Identifiable intangible asset	<u>26,853</u>
Total	<u><u>\$ 35,095</u></u>

In 2017, the Company's annual impairment test indicated that goodwill and the identifiable intangible asset summarized in the table above were not impaired.

**(5) Property and Equipment**

A summary of property and equipment at December 31, 2017 is as follows (in thousands):

		<u>Estimated useful lives</u>
Furniture and fixtures	\$ 29,509	3 – 10 years
Data processing equipment	18,364	1 – 5 years
Computer software	93,351	1 – 10 years
Equipment	20,619	2 – 26 years
Leasehold improvements	21,971	1 – 15 years
Building	11,759	1 – 30 years
Land	<u>2,843</u>	
Property and equipment, at cost	198,416	
Accumulated depreciation	<u>(114,930)</u>	
Property and equipment, net	<u><u>\$ 83,486</u></u>	

At December 31, 2017, we have property and equipment under capital leases with a cost of \$1.9 million and accumulated depreciation of \$985 thousand.

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**(6) Income Taxes**

The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2017 is presented as follows (in thousands):

Deferred tax liabilities:	
Property and equipment	\$ (6,754)
Identifiable intangible asset	(6,121)
Unrealized gains on investment securities	(2,014)
Prepaid expenses	(1,411)
Other	(183)
	<u>(16,483)</u>
Total gross deferred liabilities	(16,483)
Deferred tax assets:	
Benefit plans	3,019
Accrued compensation	5,068
Other accrued expenses	3,819
Share-based compensation	13,784
State net operating loss carryforwards	4,057
Federal benefit on state liabilities	991
Unused state tax credits	2,785
Other	367
	<u>33,890</u>
Total gross deferred assets	33,890
Valuation allowance	(4,057)
	<u>(4,057)</u>
Net deferred tax asset	<u>\$ 13,350</u>

As of December 31, 2017, 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, 2017. The carryforwards, if not utilized, will expire between 2018 and 2037. Management believes it is not more likely than not that the Company will generate sufficient future taxable income in certain states to realize the benefit of the net operating loss carryforwards, and accordingly, a valuation allowance in the amount of \$4.1 million has been recorded at December 31, 2017. The Company has state tax credits of \$2.8 million as of December 31, 2017 that can be utilized in future tax years. Of these state tax credit carryforwards, \$2.6 million will expire between 2024 and 2033 if not utilized and \$0.2 million will expire in 2026 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration dates.

As of December 31, 2017, the Company had unrecognized tax benefits, including penalties and interest, of \$5.6 million (\$4.6 million net of federal benefit) that, if recognized, would impact the Company's effective

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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; and unrecognized tax benefits that reduce a net operating loss, similar tax loss or tax credit carryforward are presented as a reduction to noncurrent deferred income taxes.

The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2017 of \$2.2 million (\$1.9 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, 2017 (in thousands):

	<b>Unrecognized tax benefits</b>
Balance at January 1, 2017	\$ 3,926
Increases during the year:	
Gross increases – tax positions in prior period	47
Gross increases – current period tax positions	144
Decreases during the year:	
Gross decreases – tax positions in prior period	(34)
Decreases due to settlements with taxing authorities	(160)
Decreases due to lapse of statute of limitations	(465)
Balance at December 31, 2017	\$ <u>3,458</u>

In the ordinary course of business, many transactions occur for which the ultimate tax outcome is uncertain. In addition, respective tax authorities periodically audit our income tax returns. These audits examine our significant tax filing positions, including the timing and amounts of deductions and the allocation of income among tax jurisdictions. During 2017, WDR closed an Internal Revenue Service audit of the 2014 tax year, in which the Company participated in the filing of a consolidated tax return. This audit was settled with no significant adjustments. Additionally, WDR is currently under audit in one state jurisdiction in which the Company participated in the filing of a combined tax return. Settlement of this audit is not anticipated to have a significant impact on reported income or loss. The 2014, 2015, 2016, and 2017 federal income tax returns are open tax years that remain subject to potential future audit. State income tax returns for all years after 2013 and, in certain states, income tax returns for 2013, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

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

The Company participates in the WDR sponsored non-contributory retirement plan (the Pension Plan) that covers substantially all employees. Benefits payable under the Plan are based on employees' years of service and compensation during the final ten years of employment. On July 26, 2017, the Compensation Committee of the Company's Board of Directors approved an amendment to freeze the Pension Plan effective September 30, 2017. After September 30, 2017, participants in the Pension Plan have not accrued additional benefits for future service or compensation. Participants will retain benefits accumulated as of September 30, 2017 pursuant to the terms of the Pension Plan. In accordance with applicable accounting standards, the Pension Plan's assets and liabilities were remeasured as of July 31, 2017, the date participants were notified of the freeze. WDR allocates pension expense or benefit to the Company for the Plan.

As of December 31, 2017, the total projected benefit obligation of the Plan is \$184.2 million, of which \$163.2 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 balance sheet at December 31, 2017 is \$13.4 million, of which \$11.8 million relates to the Company and is included in accrued pension and postretirement costs.

The Company also participates in the WDR sponsored unfunded defined benefit postretirement medical plan (medical plan) that previously covered substantially all employees and Waddell & Reed advisors. The medical plan is contributory with participant contributions adjusted annually. The contributions for each year represent claims paid for medical expenses. WDR amended this plan in 2016 to discontinue the availability of coverage for any individuals who retire after December 31, 2016, but allowed existing participants to retain retiree coverage under the plan.

Net accrued postretirement medical plan costs in the amount of \$2.2 million are recorded on the balance sheet of WDR at December 31, 2017, all of which relates to the Company. Of the Company's total liability at December 31, 2017, \$421 thousand is included in other current liabilities, while the remainder is long term in nature and is included in accrued pension and postretirement costs.

**(8) 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 to substantially all of our employees. As allowed under Section 401(k), the plan provides tax-deferred salary deductions for eligible employees.

In 2017, in connection with the Pension Plan freeze, WDR amended its 401(k) plan to permit employer discretionary nonelective contributions to eligible participants. For the 2017 plan year, the Company approved a discretionary nonelective contribution in an amount equal to 4% of such participant's eligible compensation.

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**(9) Uniform Net Capital Rule Requirements**

Waddell & Reed, Inc. 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. Waddell & Reed, Inc. made this election and is not subject to the aggregate indebtedness ratio as of December 31, 2017. At December 31, 2017, Waddell & Reed, Inc. had net capital of \$28.0 million that was \$27.8 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, including equity in subsidiaries, that are excluded from net capital.

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

Waddell & Reed, Inc. 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). Waddell & Reed, Inc. did not have any customers' fully paid securities and excess margin securities that were not in Waddell & Reed, Inc.'s possession or control as of December 31, 2017 for which instructions to reduce to possession or control had been issued as of December 31, 2017, but for which the required action was not taken by Waddell & Reed, Inc. within the time frames specified under Rule 15c3-3 of the Securities Exchange Act of 1934. Waddell & Reed, Inc. 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, 2017, 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.

**(11) 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 and have no purchase price. These awards have historically vested over four years in 33⅓% increments on the second, third and fourth anniversaries of the grant date; however, awards granted on or after December 31, 2016 vest in 25% increments on the first, second, third and fourth anniversaries of the grant date. The Company has issued nonvested stock awards to W&R independent financial advisors who are independent contractors. These awards have the same terms as awards issued to employees; however, changes in the Company's share price result in variable compensation expense over the vesting period. Beginning in 2017, the Company established a Cash Settled RSU Plan (the "RSU Plan"), which allows the Company to grant cash-settled restricted stock units ("RSUs") to attract and retain key personnel and enable them to participate in the long-term growth of the Company. Unvested RSUs have no purchase price and vest in 25% increments over four years, beginning on the first anniversary of the grant date. On the vesting date, RSU holders receive a lump sum cash payment equal to the fair market value of one share of the WDR Class A common stock, par value \$0.01, for each RSU that has vested, subject to applicable tax withholdings. We treat RSUs as liability-classified awards and, therefore, account for them at fair value

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based on the closing price of WDR Class A common stock on the reporting date, which results in variable compensation expense over the vesting period. Nonvested shares and nonvested RSU's are forfeited upon the termination of employment with or service to the Company, as applicable, or service on the Board of Directors, 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. Since nonvested RSUs are not shares of Company stock, holders of nonvested RSUs are not entitled to voting rights but are entitled to dividend equivalent payments for each RSU equal to the dividend paid on one share of WDR Class A common stock. The Company pays WDR for expenses related to these awards.

**(12) Lease Commitments**

We lease certain home office buildings, certain sales and other office space and equipment under long-term operating leases. Future minimum rental commitments under non-cancelable operating leases are as follows:

<u>Year</u>	<u>Commitments</u> <u>(in thousands)</u>
2018	\$ 19,920
2019	14,181
2020	9,050
2021	5,341
2022	2,746
Thereafter	7,489
	<u>\$ 58,727</u>

**(13) Related Party Transactions**

The current amounts due from affiliates at December 31, 2017 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, 2017 include amounts due for administrative and other services.

The amount classified as income tax receivable at December 31, 2017 consists entirely of amounts due from WDR for tax allocations.

We earn investment management fee revenues from the Advisors Funds for which we also act as an investment adviser, pursuant to an investment management agreement with each Fund. In addition, we have agreements with the Advisors Funds pursuant to Rule 12b-1 under the Investment Company Act of 1940, as amended, pursuant to which distribution and service fees are collected from the Advisor Funds for

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distribution of mutual fund shares, for costs such as advertising and commissions paid to broker/dealers, and for providing ongoing services to shareholders of the Advisor Funds and/or maintaining shareholder accounts. We also earn service fee revenues by providing various services to the Advisor Funds and their shareholders pursuant to a shareholder servicing agreement with each Fund and an accounting service agreement with the Advisor Funds. These agreements are approved or renewed on an annual basis by each Fund's board of trustees, including a majority of the disinterested members. Funds and separate accounts receivable includes amounts due from the Funds for aforementioned services.

The Company earns point of sale commissions and Rule 12b-1 fees on sales of the Ivy Funds and Ivy VIP by licensed independent financial advisors associated with the Company. The Company is program manager for a 529 plan and earns point of sale commission from the sale of Class E shares of certain Ivy Funds by licensed independent financial advisors associated with the Company and financial intermediaries that have entered into 529 plan selling agreements with the Company.

**(14) 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 establishes reserves for litigation and similar matters when those matters present material loss contingencies that management determines to be both probable and reasonably estimable in accordance with ASC 450, "*Contingencies Topic*." 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. The Company discloses the nature of the contingency when management believes it is reasonably possible the outcome may be significant to the Company's consolidated balance sheet 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 must be disclosed. Management's judgment is required related to contingent liabilities because the outcomes are difficult to predict.

**(15) Concentration of Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and debt securities held. The Company maintains cash and cash equivalents with various financial institutions. Cash deposits maintained at financial institutions may exceed the federally insured limit.

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Our investments in sponsored funds and investments held as trading expose us to market risk. The underlying holdings of our assets under management are also subject to market risk, which may arise from changes in equity prices, credit ratings, foreign currency exchange rates, and interest rates.

