

# Advisory Services

For your Waddell & Reed **CHOICE** Account



*from* Waddell & Reed

**Waddell & Reed, Inc.**  
**SEC File Number: 16720**  
**Part 2A of Form ADV: Firm Brochure**  
**Asset Allocation and Wrap Products Only Brochure**  
**The date of this Brochure is: September 1, 2012**

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

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

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

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

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

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

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

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

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

Pershing LLC  
One Pershing Place  
Jersey City, NJ 07399

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

## Summary of Material Changes

# Advisory Services

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## Advisory Business

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

### Overview and Ownership

Waddell & Reed, Inc. (Waddell & Reed) is a securities broker-dealer and a Federally registered investment advisor serving clients nationwide. Waddell & Reed was founded in 1937 and emphasizes comprehensive financial planning and provides a variety of personal financial services and investment opportunities. Through the financial planning process, Financial Advisors can help clients identify their unique financial goals and develop a plan to meet those goals. And, Financial Advisors have access to a broad array of investment and insurance products and services that can help satisfy their clients' planning needs.

Waddell & Reed is a wholly owned subsidiary of Waddell & Reed Financial, Inc., a publicly held company (NYSE: WDR). Waddell & Reed provides highly competitive mutual fund offerings, including the Waddell & Reed Advisors Funds, the Ivy Funds, the Ivy Funds VIP offered within variable insurance products provided by our strategic insurance partners (currently Minnesota Life Insurance Company and Nationwide Life Insurance Companies (collectively the "Strategic Partners")) and the InvestEd Portfolios offered within The Ivy Fund's InvestEd 529 Plan (collectively the "Waddell & Reed Mutual Funds").

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

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

**Focus on growing and protecting investors' assets:** a sound approach that seeks to capture asset appreciation when market conditions are favorable, and strives to manage risk consistent with the objectives of the Waddell & Reed Mutual Funds.

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

### Advisory Services Generally

This brochure gives you information about the costs and benefits of our asset management process and certain asset allocation products managed by Waddell & Reed and Wrap advisory programs sponsored and/or managed by Lockwood Advisors, Inc. and offered through Waddell & Reed.

We are dedicated to high-quality service for the duration of our relationship, which may span a lifetime of financial decision-

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

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

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

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

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

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

Except as otherwise provided, your financial advisor does not have any discretionary authority over the decision to purchase or sell investment and insurance products. Your financial advisor must always give you the final authority to determine how your assets are invested and what investment and insurance products to purchase or sell within the parameters and as allowed in the asset allocation or wrap programs you participate in. Your financial advisor is not permitted to provide advice to purchase or sell investment or insurance products that cannot be purchased by you through your financial advisor at Waddell & Reed. For example, your financial advisor cannot actively manage assets maintained

in a 401(k) plan sponsored by your employer or in an account at another brokerage firm.

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

## Mutual Fund Asset Allocation Programs

Waddell & Reed offers a number of basic mutual fund asset allocation programs to a certain group of clients that want the flexibility to hold their securities in a brokerage account at Pershing LLC. Clients should note that they have limited ability to impose investment restrictions on our mutual fund asset allocation programs. Clients may only select from the Waddell & Reed Mutual Funds or other mutual funds available in the model portfolios in these programs. The asset allocation programs are described in more detail below:

### Strategic Portfolio Allocation

Waddell & Reed currently offers an asset allocation advisory service known as SPA. Waddell & Reed's Investment Policy Committee utilizes a variety of tools, including fundamental analysis and computer-generated analysis, to develop SPA asset allocation models for various market and economic conditions. The computer-generated analysis is provided by Legend Advisory Corporation ("LAC"), a company under common control with Waddell & Reed. Clients' assets are allocated between and among shares of Waddell & Reed Mutual Funds including domestic and international equity funds, money market and fixed income funds and total return funds.

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

SPA clients' investments are allocated in accordance with the model selected by the client. Prior to the initial allocation into the model selected by a SPA client, the client's initial and subsequent investments will be invested temporarily in Waddell & Reed Advisors Cash Management, a money market mutual fund, subject to change at the discretion of Waddell & Reed (collectively referred to as SPA Primary Fund). Investments in the SPA Primary Fund are then exchanged in accordance with a schedule established by Waddell & Reed into Class A shares purchased at net asset value (NAV Shares) that are available in each model. Due to a variety of factors, there may be delays between the receipt of transaction requests from clients and the processing of such requests. Initial and subsequent purchases from the SPA Primary Fund are made in accordance with the percentage allocations of the model selected by the client in effect at the time of purchase. Partial redemptions

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

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

Investments available in the SPA Asset Allocation models are limited to the Waddell & Reed Mutual Funds, which include Waddell & Reed Advisors Funds, for which Waddell & Reed serves as principal underwriter, and the Ivy Funds for which an affiliate of Waddell & Reed, Ivy Funds Distributor, Inc., serves as principal underwriter. In addition to the advisory fees charged in connection with a SPA account, clients will be subject to fund-level expenses as described in the applicable funds' prospectuses. Class A shares of the Waddell & Reed Mutual Funds on which the applicable front-end load has been assessed are not eligible to be managed in a SPA account unless three years have elapsed from the date such shares were purchased. Waddell & Reed Mutual Funds Class B and C shares and variable annuities may not be managed in a SPA account.

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

Waddell & Reed is paid ongoing 12b-1 fees, as described in the applicable funds' prospectuses, in addition to the SPA advisory fee. Financial advisors of Waddell & Reed receive a portion of the 12b-1 fees attributable to the sale of mutual fund shares within a SPA account, as well as a portion of the SPA advisory fee. The expenses applicable to the mutual funds available within SPA are described in the applicable funds' prospectuses. Waddell & Reed subsidiary, Waddell & Reed Investment Management Company, is paid management fees by the mutual funds in the Waddell & Reed Advisors Funds, as described in the applicable funds' prospectuses. Waddell & Reed affiliate, Ivy Investment Management Company, is paid management fees by the mutual funds in the Ivy Funds family, as described in the applicable funds' prospectuses. Waddell & Reed subsidiary, Waddell & Reed Services Company, is paid shareholder and accounting services fees by the mutual funds



in the Waddell & Reed Advisors Funds, and the Ivy Funds, as described in the applicable funds' prospectuses. Participation in a SPA account is not necessary to purchase shares of mutual funds in the Waddell & Reed Advisors Funds, and the Ivy Funds. Clients will receive confirmations of mutual fund purchases resulting from new investments in, and of mutual fund redemptions from, their SPA accounts. Mutual fund purchases, redemptions and exchanges resulting from reallocation, rebalancing and payment of advisory fees will be confirmed on clients' quarterly statements.

Exchanges between the mutual funds within a SPA account, and redemptions to pay advisory fees for SPA services, may constitute taxable events if done outside a tax-advantaged account or product and may result in tax liability and/or tax withholding. Prospective clients are encouraged to consult a tax advisor to determine the tax consequences of participation in SPA. Redemptions of mutual fund shares from SPA accounts may cause a client's allocations to deviate from the allocation of the model selected by the client. Dividend and capital gains distributions paid by the mutual funds in a SPA account are automatically reinvested to purchase additional shares of the distributing mutual fund and may not be paid to the client. SPA Fees may not be paid through redemptions of securities that cause a contingent deferred sales charge.

**Note: Waddell & Reed may change, modify or terminate SPA at any time in its sole discretion.**

### Managed Allocation Portfolios

Waddell & Reed sponsors other mutual fund asset allocation programs that offer clients a selection of strategic asset allocation models, as well as features such as systematic rebalancing and client participation in determining (to a limited extent) asset allocation across asset classes, but which are generally closed to new investors as of January 1, 2011. These asset allocation programs are MAP and MAPPlus (sometimes referred to collectively as the MAP Program or Programs). After December 31, 2010, Choice clients may establish these programs only if they already have a MAP Program account and their Waddell & Reed financial advisor is in the process of converting to the Waddell & Reed Choice brokerage platform. Each MAP Program is discussed in more detail below, along with information common to both MAP Programs.

### MAP and MAP Plus

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

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

**Account Opening.** Clients must complete a questionnaire that serves to identify each client's investment objectives, risk tolerance, and investment time horizon. The client, after consultation with their financial advisor, will determine their appropriate investment profile and will select an asset allocation model, all based on the

client's responses to the questionnaire. After an asset allocation model is selected, the client and their advisor will review Waddell & Reed Mutual Funds available for each asset class in the model and the client will select at least one mutual fund for each asset class in the chosen model. Clients that elect to participate in MAPPlus may, after consultation with their financial advisor, change the weighting of the asset classes in each model within certain pre-determined parameters using a proprietary tool designed by Waddell & Reed. This tool enables MAPPlus clients to increase each model's risk and potential for return by changing the balance of one or more of the selected asset class weightings in the selected model. The ultimate decision to participate in a MAP Program, selection of the asset allocation model, selection of Waddell & Reed Mutual Funds to be used in an asset allocation model and the decision by MAPPlus clients to vary the asset class weighting within an asset allocation model is made by, and is the ultimate responsibility of, the client.

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

**Funding a MAP Program account.** All initial and subsequent investments into a MAP Program account will be made from the Waddell & Reed Advisors Cash Management Fund (the MAP Primary Fund). The MAP Primary Fund is a money market mutual fund and may be replaced by Waddell & Reed in its sole discretion at any time. Assets invested in the MAP Primary Fund are subsequently used to purchase shares of the Waddell & Reed Mutual Funds selected by the client to populate their asset allocation model. Delays may occur between the receipt of the client's MAP Program mutual fund selection and the processing of the share purchases, which may result in variances between the number of shares requested and the number of shares actually purchased. Clients may invest any amount in their MAP Program account after their initial investment. Clients may also withdraw assets from their account, so long as their account value does not drop below the then current minimum required to remain in the MAP Program they select. Additions to and withdrawals from a MAP Program account will be made through the MAP Primary Fund and in accordance with then-current account allocation in a manner that is intended to minimize variances from targeted allocations.

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

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

**Meetings and Reports.** All MAP Program clients must meet with their advisor at least annually to evaluate their ongoing participation in the MAP Programs. Clients are strongly encouraged to meet with their advisors more frequently if they have questions about their participation in the MAP Programs or if their personal or financial circumstances change. There is no additional charge for meetings or other communications to discuss the MAP Programs. Clients will receive periodic reports, statements, confirmations and updated summary prospectuses from the mutual funds in the MAP Programs. Clients should carefully read all such material.

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

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

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

**Financial Planning Services Available to MAP Program Clients.** Clients who elect to invest in a MAP Program account will be offered certain financial planning services at no additional charge. These services will be offered based on the value of assets invested and will be offered annually for the entire time the account remains open. Financial planning services will be offered in tiers based on the MAP Program account value, with more sophisticated services

available to clients who invest more assets in the account. Initially, the eligibility level for financial planning services will be determined by adding together the initial MAP Program account assets and any additions anticipated within twelve months from the date of the MAP Program Service Agreement. The MAP Program account will be valued annually thereafter on the MAP Program Service Agreement anniversary. The level of financial planning services to which the client will be entitled will be based on the value of the account on the most recent MAP Program Service Agreement anniversary date. Assets from household accounts, if any, will be included in the account valuation. MAP Program accounts will be grouped into households for determining eligibility for financial planning services. Waddell & Reed will review each MAP Program account on the anniversary of the establishment of the oldest account for the household to determine the account value for purposes of determining which financial planning services will be offered during the succeeding year. Waddell & Reed may in its sole discretion add, substitute, and/or delete financial planning services from each MAP Program at anytime in its sole discretion. If a MAP Program account is closed, any open MAP Program Financial Planning Services Agreements will be terminated. If you have a MAP Program Financial Planning Services Agreement in place and your advisor retires, leaves Waddell & Reed or your MAP Program account is reassigned to another advisor for any reason, the MAP Program Financial Planning Services Agreements will be terminated. If additional planning services are desired, you must complete a new agreement with your new advisor. Currently, the financial planning services offered and the asset levels at which they are offered are as follows:

## MAP Program

### Household Asset Value

\$50,000 to \$99,999

\$100,000 to \$249,999

Any of the Previously Listed Services, Plus:

\$250,000 to \$999,999

Any of the Previously Listed Services, Plus:

\$1,000,000 and Above

Any of the Previously

### Planning Services

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

FOCUSPlan Tax Sensitive  
Wealth Forecasting Strategy

FOCUSPlan Tax Sensitive with  
Detailed Cash Flow  
Estate Planning Strategy

FOCUSPlan Premier

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

Clients may determine that they do not need to use every financial planning service available in any given year. However, unused services do not carry over into subsequent years and services available in one year may not be available in subsequent years if the account value falls below the threshold required for those services at the next MAP Account anniversary date. Conversely, if the account value rises above a threshold, the client will be offered those financial planning services available at the new asset threshold. Clients who paid Waddell & Reed before establishing a MAP Program account for any of the financial planning services offered here will not receive a refund of that fee merely by establishing a MAP Program account at a certain asset level. Therefore, it is likely



that a client will pay their financial advisor both a fee for financial planning services and asset-based fees for a MAP Program. It is also possible that clients who establish a MAP Program account will not take advantage of any of the financial planning services available to them at no additional cost, but rather will pay their financial advisor additional fees to provide more sophisticated financial planning services than those services to which they may be entitled by virtue of establishing a MAP Program account. This is because the client's personal financial situation and goals may require more sophisticated financial planning services than the services available through the MAP Program account at no additional cost.

## Termination

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

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

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

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

1. Clients may instruct Waddell & Reed to redeem the Waddell & Reed Mutual Funds held in their MAP account and transfer the cash proceeds to the address of record on the account being terminated or to an intermediary of the client's choice.
2. Clients may instruct Waddell and Reed to transfer Ivy Fund mutual fund shares in kind to an intermediary of the client's choice so long as the intermediary has an effective selling agreement with Ivy Funds at that time. It is the client's responsibility to ensure that the intermediary they select has an effective selling agreement.
3. Clients may redeem their Waddell & Reed Mutual Funds held in the MAP account and purchase Class A shares of the Waddell & Reed Mutual Funds in a Waddell & Reed non-Map mutual fund account held direct at the Fund at no additional cost.

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

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

their tax professional before redeeming mutual fund shares in a taxable MAP account.

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

## MAPChoice

Waddell & Reed sponsors a mutual fund asset allocation program that offers clients a selection of strategic asset allocation models, as well as features such as systematic rebalancing and client participation in determining (to a limited extent) asset allocation across asset classes. This asset allocation program is MAPChoice, which is discussed in more detail below.

**Allocation Models and Asset Classes.** MAPChoice consists of five primary asset allocation models: Aggressive Growth, Growth, Conservative Growth, Income, and Conservative Income. Each MAPChoice model is constructed of up to eight asset classes, which are selected and assigned weightings within each model by Waddell & Reed. Waddell & Reed also assigns one or more of the Waddell & Reed Mutual Funds to each asset class within the model.

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

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

**Funding a MAPChoice Account.** All initial and subsequent investments into a MAPChoice account will be made from the Waddell & Reed Advisors Cash Management Fund (the MAP Primary Fund). The MAP Primary Fund is a money market mutual fund and may be replaced by Waddell & Reed in its sole discretion at any time. Assets invested in the MAP Primary Fund are subsequently used to purchase shares of the Waddell & Reed Mutual Funds selected by the client to populate their asset allocation model. A delay of at least one day will occur between the receipt of the client's MAPChoice mutual fund selection and the processing of the share purchases, which may result in variances between the number of shares requested and the number of shares actually purchased. Clients may invest any amount in their MAPChoice account after their initial investment. Clients may also withdraw assets from their account,

so long as their account value does not drop below the then current minimum required to remain in MAPChoice. Additions to a MAPChoice account will result in the account rebalancing. Withdrawals from a MAPChoice account will be made through the MAP Primary fund and may also result in a rebalancing taking place so the account returns to its target allocations.

**Changes to Mutual Funds and Asset Allocation Models.** The MAPChoice model portfolios are strategic in nature and are based on long-term historical asset class assumptions and long-term forward looking projections. Therefore, it is not likely that there will be changes to the model portfolio's asset class percentages. However, Waddell & Reed periodically reviews the composition of the MAPChoice models to determine whether the models should be modified to better reflect the economy and forecasted long-term market conditions. These reviews may result in changes to the models, asset classes, or mutual funds within the asset classes. To the extent Waddell & Reed moves one or more mutual funds from one asset category to another the client may need to select a new mutual fund to complete a model and may find that the new mutual fund they select has higher internal expenses than the mutual fund that was moved. It is important to consider that Waddell & Reed will populate the asset allocation models with only Waddell & Reed Mutual Funds. Waddell & Reed will not consider mutual funds created and managed by mutual fund companies other than Waddell & Reed or its affiliates, even though such other mutual funds may have lower internal expenses and better performance than similar Waddell & Reed Mutual Funds. Clients are encouraged to periodically reevaluate their asset allocation models to ensure that the selected model continues to be suitable and consistent with the client's evolving risk tolerance, investment objectives and time horizon. MAPChoice clients must review the propriety of their asset allocation models at least annually. MAPChoice clients are permitted two model changes and two fund changes per year. There is no additional charge for this service.

**Meetings and Reports.** Meetings for MAPChoice clients and information provided are the same as for MAP and MAPPlus clients. Please review the meetings and reports section for MAP and MAPPlus clients above.

**Account Minimums.** Clients must maintain at all times a minimum investment of \$15,000 in a MAPChoice account. In the event that an account falls below its minimum, Waddell & Reed may terminate its agreement with the client and redeem all of the mutual fund holdings in the account. The redemption proceeds will be transferred to the client's MAP Primary Fund. Nevertheless, clients may deposit less than the minimum investment (currently \$15,000 for MAPChoice accounts) in the rare situation where the remaining cash to bring the total deposit up to the required minimum to fully fund the MAPChoice account is anticipated to be received within 90 days or less. In this situation the initial cash deposit will be invested in the Primary Fund awaiting the remaining cash. The MAPChoice account will not be established until the cash in the Primary Fund reaches the account minimum to establish the account. If this does not occur within 90 days of the initial cash deposit, the client will receive a communication from Waddell & Reed advising them that they have 30 days from the date of the notification to provide the remaining cash deposit and appropriate MAPChoice account Client Service Agreement and other required account documentation. If the client fails to deposit the cash necessary to fund the account and provide the necessary documentation within this additional 30 day notice period, the initial cash deposit will be returned to the client and the MAPChoice account will not be established.

**Nature of Available Shares.** Mutual fund shares purchased through MAPChoice are not subject to a sales load. They are class A shares purchased at net asset value (NAV). Class A shares on which a load was originally paid may be invested in MAPChoice only if

the transaction in which the shares were acquired occurred at least three years prior to the execution of the client's MAPChoice Client Service Agreement.

**Financial Planning Services Available to MAPChoice Clients.** Clients who elect to invest in a MAPChoice account will be offered certain financial planning services at no additional charge. These services will be offered based on the value of assets invested and will be offered annually for the entire time the account remains open. Please read carefully the discussion of financial services for MAP Program clients discussed under MAP and MAPPlus above. These are the same services offered on the same terms to MAPChoice clients.

**Termination.** Please review the termination provisions for MAP and MAPPlus above. These same provisions apply to the termination of MAPChoice accounts.

**Note: Waddell & Reed may change, modify or terminate MAPChoice at any time in its sole discretion.**

### **Managed Allocation Portfolios FLEX (MAPFlex)**

Waddell & Reed sponsors a mutual fund asset allocation program that offers clients a selection of strategic asset allocation models, broad choice of mutual funds, including Waddell & Reed Mutual Funds, as well as features such as systematic rebalancing and client participation in determining (within pre-determined parameters) asset allocation across asset classes. This asset allocation program is Managed Allocation Portfolios FLEX (referred to in this section as MAPFlex Program). The MAPFlex Program is discussed in more detail below.

**Allocation Models and Asset Classes.** The MAPFlex Program consists of five asset allocation models: Aggressive Growth, Growth, Conservative Growth, Income, and Conservative Income. Each MAPFlex Program model consists of eight asset classes, which are selected and assigned weightings within each model by Waddell & Reed.

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

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

**Funding a MAPFlex Program Account.** All initial and subsequent investments into a MAPFlex Program account will be made from the Waddell & Reed Advisors Cash Management Fund (the MAP Primary Fund). The MAP Primary Fund is a money market mutual fund and may be replaced by Waddell & Reed in its sole discretion at any time. Assets invested in the MAP Primary Fund are subsequently used to purchase shares of mutual funds, which may include Waddell & Reed Mutual Funds, selected by the client to populate their asset allocation model. A delay of at least one day will occur between the receipt of the client's MAP Program mutual fund selection and the processing of the share purchases, which may result in variances between the number of shares requested and the number of shares actually purchased. Clients may invest any amount in their MAPFlex Program account after their initial investment. Clients may also withdraw assets from their account, so long as their account value does not drop below the then current minimum required to remain in the MAPFlex Program. Additions to a MAPFlex account will result in the account rebalancing. Withdrawals from a MAPFlex account will be made through the MAP Primary fund and may also result in a rebalancing taking place so the account returns to its target allocations.

**Changes to Mutual Funds and Asset Allocation Models.** The MAP model portfolios are strategic in nature and are based on long-term historical asset class assumptions and long-term forward looking projections. Therefore, it is not likely that there will be changes to the model portfolio's asset class percentages. However, Waddell & Reed periodically reviews the composition of the MAP program models to determine whether the models should be modified to better reflect the Investment Policy Committee's analysis of the economy and forecasted long-term market conditions. These reviews may result in changes to the models, asset classes, or mutual funds within the asset classes. To the extent Waddell & Reed moves one or more mutual funds from one asset category to another the client may need to select a new mutual fund to complete a model and may find that the new mutual fund they select has higher internal expenses than the mutual fund that was moved. Clients are encouraged to periodically reevaluate their asset allocation models and mutual fund selections to ensure they continue to be suitable and consistent with their evolving risk tolerance, investment objectives and time horizon. MAPFlex Program clients should review the propriety of their asset allocation models with their advisor at least annually, and their selected funds two times per year. There is no additional charge for this service. Nevertheless, the client will be asked to complete a new risk tolerance questionnaire in order to complete model changes.

**Meetings and Reports.** Meetings for MAPFlex clients and information provided are the same as for MAP and MAPPlus clients. Please review the Meetings and Reports sections for MAP and MAPPlus clients above.

**Account Minimums.** Except as provided immediately below and in the second full paragraph following this paragraph, MAPFlex Program accounts must be established with and maintain at all times assets valued at \$50,000. However, Waddell & Reed may in its sole discretion establish and maintain a new MAPFlex Program account with assets valued at less than \$50,000 but more than \$25,000 in instances where the MAPFlex account is funded by mutual fund shares transferred into the new MAPFlex Program account from another, non-Waddell & Reed, mutual fund asset allocation investment advisory program. MAPFlex Program accounts must thereafter maintain a minimum balance of \$50,000 or \$25,000 respectively depending on the source of the invested assets. Waddell & Reed may terminate the MAPFlex Program agreement with any client and convert the MAPFlex Program account to a standard brokerage account held at Pershing LLC in the event that an account falls below its respective minimum balance.

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

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

**Termination.** The MAPFlex Program Service Agreement may be terminated at any time by the client upon written notice to Waddell & Reed as provided in the Service Agreement and upon thirty days prior written notice by Waddell & Reed. If the client terminates the Service Agreement within five business days from the date they execute the Service Agreement, the client will pay no fees or penalties. Thereafter, if the client terminates the agreement, the client will receive a pro-rated refund of their asset-based fee. Upon termination Waddell & Reed will, unless otherwise instructed by client, sell the mutual funds in the client's account and invest the cash proceeds in the MAP Primary Fund until the client provides instructions to forward the proceeds. This process may have adverse tax consequences for taxable accounts. If the client and their advisor decide to reinvest the proceeds in mutual funds through Waddell & Reed, the client will pay the then-applicable front-end load to purchase Class A shares.

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



# SMA and UMA Programs Offered Through Lockwood Advisors, Inc.

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## Managed Account Advisor and Lockwood Sponsored Program

Lockwood Advisors, Inc. (Lockwood) sponsors, manages and provides access to individual account managers and investment advisory and discretionary services to financial advisors such as investment advisors, which in turn provide investment advice to their clients. Waddell & Reed has engaged Lockwood to provide Waddell & Reed access to two of its account manager services offered through Lockwood's Managed Account Advisor® (MAA); Lockwood Sponsored Program (LSP), (collectively the "SMA Programs") and the Lockwood Investment Strategies program (LIS, a unified managed account). Each of these programs is sponsored by Lockwood and discussed in more detail below.

### SMA Programs

The SMA programs enable Waddell & Reed to make available to clients certain investment managers contractually engaged by Lockwood to manage a client's assets in a discretionary manner and based on the client's individual investment needs and goals.

**Managed Account Process.** The client's financial advisor will utilize software and documentation provided by Lockwood to select an investment style allocation and/or diversified portfolio of investment, including investment vehicles and/or separate account managers (Managers). The financial advisor will assist the client with account opening paperwork to establish an account with Lockwood. All of this information is submitted to Lockwood for review and approval. As part of this process, the client will grant limited investment discretion to the Manager(s) selected. Managers will exercise this authority in the day-to-day portfolio management of the client's assets. The financial advisor will meet with clients participating in the SMA programs at least annually to determine whether the client's financial situation, risk tolerance, investment or personal goals and objectives, or time horizon have changed materially. Changes will be immediately forwarded to Managers by Lockwood to the extent that such changes could impact the Manager's management of the client's assets. Financial advisors may also use the changes provided by clients to recommend changes in Managers. Clients will have a limited ability to place restrictions on individual investments to be purchased by Managers and to have direct contacts with Managers.

**SMA Disclosure.** Clients must read completely and carefully this brochure, the applicable Part 2A, Appendix 1 and Part 2B of Form ADV provided by Lockwood and the Form ADV: Part 2A and B provided by each Manager the client selects. Clients should not invest in the SMA programs without first reading thoroughly all of these important disclosures. Lockwood has not established a minimum investment to participate in the SMA programs. However, many Managers do establish minimum investment amounts to manage client assets. Generally, Managers will not accept accounts under \$100,000. Waddell & Reed believes that clients with less than \$100,000 to invest will not gain the diversification necessary among Managers and investment styles to benefit fully from the SMA program.

### LIS

LIS is a unified managed account program managed by Lockwood.

**Investment Models and Asset Classes.** LIS consists of five core models and variations of the models, all of which span the risk/return spectrum. Client assets are managed on a discretionary basis by an overlay manager. Lockwood, serving as portfolio manager,

selects various sub-managers who provide strategy-specific models and/or investment vehicles. The sub-manager selection and investment model guidelines are provided by Lockwood. Lockwood exercises discretionary authority over the investment of the client's assets managed in an LIS account. LIS accounts may invest in mutual funds, exchange-traded funds, and general securities, such as stocks and bonds, and other investment vehicles selected by Lockwood. Mutual funds used in LIS accounts may charge a redemption fee if shares are redeemed within a certain timeframe. The redemption fee and holding period for each mutual fund is found in its prospectus. Clients are urged to obtain and read carefully the prospectus for each mutual fund purchased in their LIS account.

**Account Set-up.** The financial advisor will assist each client with understanding the nature of LIS, formulating the client's investment objectives, establishing the client's risk tolerance, all based on information the client provides to their financial advisor concerning their financial situation, personal and financial goals, risk tolerance, investment time horizon and other similar factors. The financial advisor will continue to monitor the client's LIS account to ensure that the investment style and investment managers selected by LCM continue to match the client's investment profile. The financial advisor must meet with the client at least annually to evaluate the client's ongoing participation.

**LIS Disclosure.** Clients must read completely and carefully this brochure and the applicable Form ADV, Part 2A, Appendix 1 and Part 2B provided by Lockwood. Clients should not invest assets in LIS without first reading thoroughly all of these important disclosures.

**Minimum Investment.** The initial minimum investment for LIS is \$250,000. In the event an account falls below the minimum, Lockwood may terminate the LIS account agreement with the client and convert the account to a standard brokerage account custodied at Pershing LLC.

**Note: Waddell & Reed may change, modify or terminate access to Lockwood and/or LIS.**

## Fees and Compensation

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The fees and other compensation we receive in connection with the asset allocation, SMA and UMA programs discussed in this brochure are described in detail below:

### Spa Fee Schedule

Clients in SPA will pay Waddell & Reed an advisory fee in accordance with the schedule below. A certain percentage of each client's SPA account will be allocated to the SPA Cash Management fund from which the advisory fee will be paid. Such allocation may impact the performance of SPA accounts. The fee will be calculated on the market value of the account on the last day of the previous quarter and collected by Waddell & Reed quarterly in advance from the SPA Cash Management fund. The fee will be reported on the quarterly statement received by clients during the quarter after it is collected. Upon termination of an agreement prior to a quarter's end, any unearned fee will be refunded on a pro rata basis. Advisory fees are subject to change at any time.

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

The higher fee rate will apply to account balances up to and including the stated amounts, even if the account balance exceeds the maximum account value range applicable to the stated fee rate. Lower fee rates will apply only to the balance of the account in excess of the stated amounts. Multiple SPA Accounts may be grouped for purposes of determining the applicable fee rates to the extent that the accounts qualify for "Account Grouping" as that term is defined in the then current prospectus for the Waddell & Reed Mutual Funds. Currently, Class A shares purchased with applicable sales charges will not be eligible to be included in a SPA Account unless they were purchased three (3) years or more prior to their transfer to a SPA Account.

### **Managed Allocation Portfolio (MAP) Program Fee Schedule**

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

#### *Contingent Fee Disclosure*

• **Contingent Fee.** Waddell & Reed will pay its financial advisors blended compensation of up to 2.34% of the value of all assets invested in MAP accounts. This compensation is not paid to financial advisors who establish MAPPlus accounts. The purpose is to compensate the Financial Advisor for services they will provide in connection with the establishment of a MAP account. These services include:

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

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

Except as provided below, if the client terminates their MAP account for any reason or withdraws assets from their MAP account during the first three years after the MAP account is established, the compensation originally advanced by Waddell

& Reed to the financial advisor will be recouped from the client's account assets according to the following schedule:

**First year – An amount equal to 3% of the amount originally invested in the new MAP account (without giving effect to any appreciation in the account).**

**Second year – An amount equal to 2% of the amount originally invested in the new MAP account (without giving effect to any appreciation in the account).**

**Third year – An amount equal to 1% of the amount originally invested in the new MAP account (without giving effect to any appreciation in the account).**

**Fourth year — Zero.**

- The Contingent Fee schedule described above will apply to all additional contributions to MAP accounts. The contingent fee is in addition to the asset-based fees described below.
- The Contingent Fee may act as a disincentive to clients that wish to terminate their MAP account.
- Clients must consider that, if they terminate their MAP account during the first three years after inception because of a change of their Financial Advisor, a change of personnel at Waddell & Reed or any affiliates, a change in the overall investment strategy of MAP, or changes in the performance of the client's selected MAP asset allocation model and/or selected mutual funds, or any other reason, the contingent fee will nevertheless be assessed against the client's MAP account assets.

MAP account clients may withdraw assets from their MAP accounts during the first three years under the following limited circumstances without Waddell & Reed recouping any of the contingent compensation paid to the Financial Advisor from these withdrawals, as follows:

- Clients may withdraw assets from their MAP account so long as the withdrawals are established under a systematic withdrawal service, so long as the total amount withdrawn from the MAP account under the systematic withdrawal plan during any 12-month period within the first three years after the MAP account is established is no more than 12% of the MAP account value at the time of the last withdrawal during the 12-month period and so long as the total withdrawals do not cause the MAP account value to fall below the then minimum account value necessary to establish a MAP account.
- Withdrawals requested within one year from the date of a client's death or disability, so long as Waddell & Reed is notified in writing at its corporate headquarters of the death or disability, the person requesting the withdrawal provides proof of the death or disability satisfactory to Waddell & Reed in its sole discretion and the amount of the withdrawal does not reduce the then value of the MAP account below the then minimum account value necessary to establish a MAP account.
- Withdrawals necessary to satisfy a required minimum distribution from a retirement account as provided for under the then current provisions of the IRS Code, so long as the withdrawals do not reduce the then value of the MAP account below the then minimum account value necessary to establish a MAP account.

**Note: The contingent fee schedule described above will apply to all additional contributions to MAP accounts. The contingent fee is in addition to the asset-based fees described below. The contingent compensation recouped will be determined according to a formula selected by Waddell & Reed in its sole discretion. This formula may be changed at any time and may or may not be applied to earnings on a pro rata basis.**



**Clients must consider that, if they terminate their MAP account during the first three years after inception because of a change of their financial advisor, a change of personnel at Waddell & Reed or any affiliates, a change in the overall investment strategy of MAP, or changes in the performance of the client's selected MAP asset allocation model and/or selected mutual funds, or any other reason, the contingent fee will nevertheless be assessed against the client's MAP account assets.**

**Asset-Based Fees.** Clients who participate in MAP or MAPPlus will pay an ongoing asset-based fee to cover the cost of such services as consulting and administrative services, creation and continual maintenance of the proprietary tool used to select asset category percentages in MAPPlus accounts, ongoing monitoring of and periodic revisions of the model portfolios, and services provided by each client's financial advisor, including annual and other periodic meetings for account reviews, answering client inquiries, assistance with annual tax reporting on account performance and meeting with clients as required to reassess the propriety of their current asset allocation model selection. Fees are computed on the market value of the account on the last day of the previous quarter. Fees are collected by Waddell & Reed quarterly in advance. Upon termination of an agreement prior to a quarter's end, any unearned fee will be refunded on a pro rata basis. MAP Program accounts will be allocated in a manner so that the cash asset class will be targeted at approximately 2% of the overall MAP Program account value. The cash portion of MAP Program accounts will be maintained in the Cash Management. Quarterly MAP Program fees will be deducted automatically from the Primary Fund. Nevertheless, if during any quarter there is insufficient cash in an account to pay the MAP Program fee, Waddell & Reed may in its sole discretion sell shares of the mutual funds held in the account in amounts necessary to raise sufficient cash to pay the quarterly fee. MAP program fees may not be paid through redemptions of securities that cause a contingent deferred sales charge. Waddell & Reed may change these fees at any time in its sole discretion. Clients may terminate their MAP Program Account immediately by delivering written notice of termination to Waddell & Reed, as provided in the MAP Service Agreement. The current fees for the MAP Programs are described as follows:

### MAP Asset-Based Fees

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

### MAPPlus Fees

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

1. MAP Program accounts that qualify for account grouping will be aggregated to determine applicable fee rates.
2. The client's financial advisor will not be paid any portion of the applicable asset-based fee charged to MAP accounts during the first three years after the account is established.
3. Assets transferred from existing MAP accounts into MAP Program accounts will be charged current MAP Program fees beginning on the date the new MAP Program account is established.

4. Class A shares originally purchased with a sales load may not be transferred into the MAP Programs unless the transaction in which the shares were acquired occurred at least three years prior to the execution of the client's MAP Service Agreement.
5. Each mutual fund in the MAP Programs pays an ongoing distribution and service (12b-1) fee to Waddell & Reed. Some or all of this fee may be paid to the client's financial advisor in addition to the fees described above. This fee will be paid from the date the mutual fund shares are purchased.

### MAPChoice Fee Schedule

**Asset-Based Fees.** Clients who participate in MAPChoice will pay an ongoing asset-based fee to cover the cost of services such as consulting and administrative services, creation and continual maintenance of the proprietary tool used to select asset category percentages in MAPChoice accounts, ongoing monitoring of and periodic revisions of the model portfolios, and services provided by each client's financial advisor, including annual and other periodic meetings for account reviews, answering client inquiries, assistance with annual reporting on account performance and meeting with clients as required to reassess the propriety of their current asset allocation model selection. Fees are computed on the market value of the account on the last day of the previous quarter. Fees are collected by Waddell & Reed quarterly in advance. Upon termination of an agreement prior to a quarter's end, any unearned fee will be refunded on a pro rata basis. MAPChoice accounts will be allocated in a manner so that the cash asset class will be targeted to be between 2-5% of the overall MAPChoice account value. The cash portion of MAPChoice accounts will be maintained in the Primary Fund. Quarterly MAPChoice fees will be deducted automatically from the Primary Fund. Nevertheless, if during any quarter there is insufficient cash in an account to pay the MAPChoice fee, Waddell & Reed may in its sole discretion sell shares of the mutual funds held in the account in amounts necessary to raise sufficient cash to pay the quarterly fee. MAPChoice fees may not be paid through redemptions of securities that cause a contingent deferred sales charge. Waddell & Reed may change these fees at any time in its sole discretion. Clients may terminate their MAPChoice Service Agreement immediately by delivering written notice of termination to Waddell & Reed, as provided in the MAPChoice Service Agreement. The current fees for MAPChoice are set forth below.

### MAPChoice Asset-Based Fees

<u>Value of Assets</u>	<u>Program Fee 1, 2, 3, 4, 5</u>
On the first \$300,000.00	from 1.0% to 2.0%
On the next \$700,000.00	from 0.9% to 1.9%
On assets in excess of \$1 million	from 0.8% to 1.8%

1. MAPChoice accounts that qualify for account grouping will be aggregated to determine applicable fee rates.
2. The client's financial advisor may elect to be paid the first year of the applicable asset-based fee charged to MAPChoice accounts as an advance when the account is established. The advisor will then not receive a portion of the quarterly fee until the advance has been recouped. Nevertheless, your fee will not change from the Fee Schedule as determined in your MAPChoice specific service agreement.
3. Assets transferred from existing MAP accounts into MAPChoice accounts will be charged current MAPChoice fees beginning on the date the new MAPChoice account is established and the minimum balance is funded.

4. Class A shares originally purchased with a sales load may not be transferred into MAPChoice unless the transaction in which the shares were acquired occurred at least three years prior to the execution of the client's MAPChoice Service Agreement.
5. Each mutual fund in MAPChoice pays an ongoing distribution and service (12b-1) fee to Waddell & Reed. Some or all of this fee may be paid to the client's financial advisor in addition to the fees described above. This fee will be paid from the date the mutual fund shares are purchased.

## MAPFlex Fee Schedule

**Asset-Based Fees.** Clients who participate in the MAPFlex Program will pay an ongoing asset-based fee to cover the cost of such services as consulting and administrative services, clearing, custody and account-related services, ongoing monitoring of and periodic revisions of the model portfolios, and services provided by each client's financial advisor, including annual and other periodic meetings for account reviews, answering client inquiries, assistance with annual tax reporting on account performance and meeting with clients as required to reassess the propriety of their current asset allocation model selection. Fees are computed on the market value of the account on the last day of the previous quarter.

Fees are collected by Waddell & Reed quarterly in advance. Upon termination of an agreement prior to a quarter's end, any unearned fee will be refunded on a pro rata basis. MAPFlex Program accounts will be allocated in a manner so that the cash asset class will be targeted to be between 2-5% of the overall account value. The cash portion of MAPFlex Program accounts will be maintained in the Primary Fund. Quarterly MAPFlex Program fees will be deducted automatically from the Primary Fund. MAPFlex Program fees may not be paid through redemptions of securities that cause a contingent deferred sales charge. Waddell & Reed may change these fees at any time in its sole discretion. In the event of a fee increase, clients may either accept the fee increase and continue or terminate their MAPFlex Service Agreement immediately by delivering written notice of termination to Waddell & Reed, as provided in the MAPFlex Program Service Agreement. Fees for the MAPFlex Program are negotiable within each asset range. The current minimum and maximum fees for the MAPFlex Program are described below.

## MAPFlex Fees

Value of Assets	Program Fee 1, 2	
	Min	Max
On the first \$300,000.00	0.95%	2.20%
On the next \$700,000.00	0.675%	1.93%
On assets in excess of \$1 million	0.35%	1.35%

1. MAPFlex Program accounts that qualify for account grouping will be aggregated to determine applicable fee rates.
2. Mutual funds in the MAPFlex Program generally pay an ongoing distribution and service (12b-1) fee to Waddell & Reed. Some or the entire fee may be paid to the client's financial advisor in addition to a portion of the fees described above. This distribution and service fee will be paid from the date the mutual fund shares are purchased by the client.

## Lockwood MAA, LSP, and LIS Programs Fee Schedule

### LSP Fees

Clients will pay an asset-based fee to Lockwood quarterly that will cover Lockwood's sponsor and advisory fees and Pershing clearing and custody of account assets. These services may change from time to time. Lockwood's fees vary depending on the amount of assets the client places with Equity/Balanced and Fixed Income Managers. Each Manager charges a separate fee for its ongoing discretionary asset management services. Clients should review the applicable Lockwood Form ADV, Part 2A Appendix 1 to determine the exact fees they will pay to Lockwood and the Managers to participate in the SMA program. In addition to these fees, clients will pay Waddell & Reed an asset-based fee for its consulting and client services. The total fee a client may pay to Waddell & Reed, Lockwood, Pershing, and the Manager is negotiable and will range from 1.03% to 2.40% of assets invested with Equity/Balanced Managers and from 0.64% to 1.69% of assets invested with Fixed Income Managers. These fees apply across all asset brackets. Fees payable to Waddell & Reed are automatically deducted from each SMA program account quarterly in advance and are computed on the market value of the SMA program account on the last day of the previous quarter. The unearned portion of the collected fees will be refunded pro rata if a SMA program account is closed prior to a quarter's end. Waddell & Reed may change the fees it charges at any time in its sole discretion.

### LIS Fees

Clients will pay an asset-based program fee to Lockwood quarterly that will cover the Lockwood advisory fee, Lockwood's sponsor fee, the sub-manager fees, and Pershing clearing and custody fee. Clients should review the applicable Lockwood Form ADV, Part 2A Appendix 1 to determine the extent of this fee. In addition to the fee paid to Lockwood, clients will pay Waddell & Reed an asset-based fee for its consulting and client services. The total fee a client may pay to Waddell & Reed, Lockwood, Pershing, and the Manager is negotiable and will range from a minimum of 1.00% to a maximum of 2.25% across all asset brackets. Fees payable to Waddell & Reed are automatically deducted from the LIS account quarterly in advance and are computed on the market value of the LIS account on the last day of the previous quarter. The unearned portion of collected fees will be refunded pro rata if a LIS account is closed prior to a quarter's end.

### Flow Billing

As clients add and withdraw money from the SPA, MAP and MAPFlex programs described in this brochure, their accounts may not be charged immediately. At account inception, the amount billed will be contingent on the fee agreed upon between the client and advisor and the number of days remaining in the quarter. Thereafter, clients will be billed at the beginning of the quarter in advance. Flow billing refers to any deposits or withdrawals from the account of over \$1,000 during the quarter and after account inception. At the beginning of the quarter (starting in January 2011), an analysis is done to calculate the effect flows into and out of the account should have had on your fee for the previous quarter. These are then billed as adjustments to your quarterly fee. If you have questions about your fees charged in any of our programs, please contact your Financial Advisor.

## Conflicts of Interest

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

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

Both Waddell & Reed and your individual financial advisor are compensated when you buy mutual funds and variable insurance products through Waddell & Reed. Generally, your Financial Advisor receives a substantial portion of the sales charge and distribution and shareholder service (12b-1) fees you pay in connection with your purchase. Sales charges and 12b-1 fees vary among products and, for mutual funds, among share classes. In addition to sales charges discussed above, you also pay a portion of the product's internal operating expenses.

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

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

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

Financial Advisors may also charge a fee to prepare a written financial plan from which they may make an investment recommendation. The investment recommendation may be implemented through any financial services firm and need not be implemented through Waddell & Reed. Should you choose to implement the recommendations through Waddell & Reed and its

affiliates, you will incur costs in addition to the fees you will pay for your financial plan. Depending on the products or investment advisory services you decide to purchase through Waddell & Reed and its affiliates, you may pay more or less than if you purchased similar products and investment advisory services through other financial services firms.

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

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

## Types of Clients

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

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

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

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

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

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

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

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



We do not believe that the mutual funds and asset allocation programs described in this brochure involve significant or unusual risks to our clients. However, the SMA and LIS Programs managed by and/or offered through Lockwood may, depending on the manager(s) and management style(s) you select, present a significant risk of loss. And the products selected by the managers may also present significant or unusual risks of loss. So we strongly recommend that you read carefully the disclosure materials for the SMA and LIS programs discussed in more detail in Advisory Business above.

## Disciplinary Information

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

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

On July 24, 2006, Waddell & Reed entered into settlements with the U.S. Securities and Exchange Commission ("SEC"), the Attorney General of the State of New York ("NYAG") and the Kansas Securities Commissioner ("KSC") resolving their investigations into alleged market timing activities of shareholders of certain mutual funds for which Waddell & Reed serves as principal underwriter and distributor (the "Funds"). Based upon its investigation, the SEC alleged that a subsidiary of Waddell & Reed, Waddell & Reed Investment Management Company ("WRIMCO"), violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act") by following certain Fund Shareholders to engage in frequent trading of Fund shares in exchange for fees paid to Waddell & Reed and another Waddell & Reed subsidiary, Waddell

& Reed Services Company ("WRSCO"), and that WRIMCO allowed such trading in the Waddell & Reed Advisors International Growth Fund (the "International Fund") despite having been notified that the shareholders were harming the International Fund through dilution and failed to disclose the conflict of interest to the Funds' Board of Directors and shareholders. The SEC also alleged that Waddell & Reed and WRSCO aided and abetted and caused WRIMCO's alleged violations of Sections 206(1) and 206(2) of the Advisers Act by negotiating agreements with the shareholders allowing their trading of the Funds within certain defined limits and receiving financial benefit therefrom, and that WRIMCO, Waddell & Reed and WRSCO violated Section 17(d) of the Investment Company Act of 1940 (the "40 Act") and Rule 17d-1 thereunder by participating in and effecting transactions in connection with joint arrangements in which the Funds were participants without filing an application with or receiving approval from the SEC. The NYAG alleged that Waddell & Reed's conduct violated the Martin Act, Article 23-A of the General Business Law, § 349 of the General Business Law and § 63(12) of the Executive Law of the State of New York, and the KSC alleged that the conduct of Waddell & Reed, WRIMCO and/or WRSCO violated K.S.A 17-1253(a), 17-1253(b), 17-1254(m)(7), K.A.R. 81-3-1(i)(1) and/or 81-14-5(a). Without admitting or denying the alleged violations, Waddell & Reed agreed with the SEC, together with WRIMCO and WRSCO, to a censure, to cease and desist from violating Sections 206(1) and 206(2) of the Advisers Act, Section 17(d) of the 40 Act and Rule 17d-1 thereunder, to pay to the SEC \$40 million in disgorgement and a \$10 million civil penalty that will be distributed to Fund shareholders, and to implement certain compliance undertakings. Waddell & Reed also agreed with the NYAG to reduce the investment management fees on certain of the Funds by \$5 million per year for five years and to certain Fund governance undertakings, and Waddell & Reed, WRIMCO and WRSCO agreed with the KSC to pay a fine of \$2 million to be used for the education of consumers in matters concerning securities regulation and investments.

## Other Financial Industry Activities and Affiliations

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

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

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

Pershing LLC - Waddell & Reed clears its brokerage business exclusively through Pershing LLC on a fully disclosed basis. Clients that establish brokerage accounts with Waddell & Reed must establish those accounts at Pershing LLC. Clients will be subject to

the various account and transaction related costs and fees assessed by Pershing LLC, which may be higher than those charged by other broker-dealers for similar services. Also, Waddell & Reed receives a share of certain charges imposed by Pershing LLC on the brokerage accounts they carry for us.

**Waddell & Reed Mutual Funds:** 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 Waddell & Reed Mutual Funds. Also, the investment managers for the Waddell & Reed 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 Partners.

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

**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. Please read carefully the discussion about these products, Advisory Business, SMA and UMA Programs offered through Lockwood, Inc. and Pershing LLC above.

Waddell & Reed also recommends other investment advisors to our clients in connection with the Lockwood SMA and LIS programs. We do not receive any compensation from the other investment advisors. But part of the fee you pay to invest in the SMA and/or LIS programs is paid to Waddell & Reed and your Financial Advisor.

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

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

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

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

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

Our advisors may purchase or sell the same general securities

(i.e. stocks and bonds) they recommend to our Clients. We review transactions in these securities on an ongoing basis to determine whether our clients receive the best execution. We have guidelines in our Code of Ethics to ensure that you receive the most favorable price in these situations.

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

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

Please read carefully the section above entitled "Conflicts of Interest" for a thorough discussion of the conflicts that exist when our Financial Advisors recommending the Waddell & Reed Mutual Funds to clients.

## Brokerage Practices

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

Clients that decide to purchase securities available as an investment option (except the Waddell & Reed Advisor Funds, which are proprietary) in the investment advisory programs discussed in Advisory Business above or directed through the purchase of individual securities in brokerage accounts 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.

Waddell & Reed does not select other broker-dealers through which to execute securities transactions based on whether we receive client referrals from the other broker-dealer or a third party.

## Review of Accounts

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

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



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

Financial advisors must meet with participants in the programs described in this brochure at least annually to determine whether their financial situations or investment objectives have changed or whether they want to impose or modify any reasonable restrictions on the management of their accounts. Such information is recorded and maintained by the participants' financial advisors and retained in the division office files.

## **Client Referrals and Other Compensation**

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Please read carefully "Conflicts of Interest" above to learn more about Waddell & Reed and your Financial Advisor may benefit when you purchase the Waddell & Reed Mutual Funds.

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

## **Custody**

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The Waddell & Reed Mutual Funds you purchase to fund the MAP asset allocation programs discussed in Advisory Business above are held in your brokerage account at Pershing LLC. The securities you purchase in the Lockwood SMA and LIS programs discussed in Advisory Business above are also held in your brokerage account at Pershing LLC. You will receive confirmations, quarterly statements and other reports from the mutual funds you hold from Pershing LLC.

Your Financial Advisor is permitted to send our COMPASS account summary and related performance reports. However, COMPASS reports are merely unofficial account summaries and must not be relied upon as an accurate, complete statement of your account holdings, activity or performance.

## **Investment Discretion**

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In specific situations Waddell and Reed will allow limited investment discretionary services to be offered by qualified and approved advisors to specific approved clients. Within MAPFlex, you may authorize your Waddell and Reed, Inc (WRI) advisor representative to have limited investment discretion over your account. An advisor must receive written approval from Waddell & Reed's Home Office prior to offering investment discretion services to you. Once an advisor is approved to offer discretion, they must obtain written authorization from you prior to exercising any discretionary authority over your account. This limited discretionary trading authority will be granted in the appropriate client services agreement or via a separate discretionary trading authorization form. If discretionary authority is granted, it is limited to the ability to purchase and exchange mutual funds within your chosen risk profile and investment model. If your risk profile or model choice needs to be modified, this will require you and your advisor to complete a new Risk Tolerance Questionnaire and a client services agreement prior to changes being made to your existing model. Our advisors are prohibited from having the ability to withdraw funds or securities from your account without your express written permission.

All clients have the ability to place reasonable restrictions on the management of their account including restrictions on the type of securities that can be purchased in the account. Clients may also place reasonable limitations on the discretionary power granted to WRI advisor representatives, so long as the limitations are specifically set forth as an attachment to the client services agreement.

We also 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.

We encourage you to discuss with your advisor representative the positives and negatives of authorizing limited discretion on your accounts.

## **Voting Client Securities**

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



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

Consolidated Balance Sheet

December 31, 2011

(With Report of Independent Registered Public Accounting Firm Thereon)



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

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

The Board of Directors  
Waddell & Reed, Inc.:

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

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

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

**KPMG LLP**

Kansas City, Missouri  
February 28, 2012

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

Consolidated Balance Sheet

December 31, 2011

(In thousands)

**Assets**

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

**Liabilities and Stockholder's Equity**

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

See accompanying notes to consolidated balance sheet.

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

Notes to Consolidated Balance Sheet

December 31, 2011

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

**(a) Organization**

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

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

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

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

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

(Continued)



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

Notes to Consolidated Balance Sheet

December 31, 2011

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

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

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

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

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

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

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

**(f) *Investment Securities***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**(k) *Revenue Recognition***

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

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

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

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

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

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

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

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

**(l) *Income Taxes***

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

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

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

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

**(2) Investment Securities**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**(4) Property and Equipment**

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

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

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

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**(5) Income Taxes**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**(7) Employee Savings Plan**

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

**(8) Net Capital Requirements**

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

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

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

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

**(10) Share-Based Compensation**

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

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

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

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

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

**(12) Transactions with Related Parties**

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

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

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**(13) Contingencies**

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

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

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

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

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

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

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