

# Advisory Services

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Financial Planning

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## COVER PAGE

Waddell & Reed, Inc.  
SEC File Number: 16720  
Part 2A of Form ADV: Firm Brochure  
Financial Planning Services Brochure  
The date of this Brochure is: March 28, 2017

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

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

Waddell & Reed, Inc. is a federally registered Investment Advisor and a broker-dealer and member of FINRA.  
Note: Registration with the SEC as an Investment Advisor does not imply a certain level of skill or training.

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

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

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

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

## SUMMARY OF CHANGES

Since our last Part 2A filing, Waddell & Reed has updated this brochure to include information related to its Financial Planning Activities. Items that have been updated include:

1. Restructuring of our Financial Planning Services model and program offerings.
2. The addition of new resources and technology to assist clients and advisors in organizing and tracking their financial accounts, income, expenses and budget.
3. Increased focus and documentation of the complexity of each client's financial situation and case.
4. Discussion of negotiable fees and how the complexity of each client's situation and case will lead to an appropriate fee for the financial planning services provided.
5. Removed all references to the Investment Planning Service (IPlan) as this service is no longer available as a fee based advisory offering.

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## ADVISORY BUSINESS

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

### *Overview and Ownership*

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

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

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

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

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

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

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

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

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

- Work with your Financial Advisor to determine the most appropriate financial goals to be evaluated and addressed during the term of the engagement.

- Identify any material life events, economic factors, changes in your financial situation, goals or any other issues that may cause a change in the advice given by your Financial Advisor and notify your Financial Advisor of such changes.
- Negotiate and agree upon the fee for your Financial Advisor's expertise and services. This fee is separate from any compensation you will pay or that your Financial Advisor may receive for or in connection with product sales and investment advisory programs, such as commissions and/or investment advisory fees.
- Understand the benefits of and limits to the financial planning process and form reasonable expectations with respect to the results to be obtained from your personal financial plan and recommended investment strategy.

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

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

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

## A. Financial Planning Services Offered:

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

### 1. Financial Planning Service

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

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

## 2. Premier Financial Planning Service

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

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

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

## 3. W&R Wealth Management Site

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

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

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

The consolidated view and reporting functionality available through the W&R Wealth Management Site is provided for informational purposes only and as a courtesy to you. These reports may include assets that Waddell & Reed does not hold on your behalf and which are not included on Waddell & Reed's books and records. While Waddell & Reed believes the information on the consolidated view and reporting functionality to be accurate,

Waddell & Reed may not be the custodian of all of your assets, and therefore cannot be responsible for any inaccurate reporting of assets it does not custody. We urge you to compare these reports and the information reflected on the reports to the official account/policy statements provided by the custodians of your account/policy holdings to ensure that the information listed on these reports match the securities, insurance, cash, bank deposit and other holdings reflected on the official account statements provided by the custodians of your assets.

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

## B. Financial Analysis Tools

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

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

1. **Financial Planning Tools:** The financial planning service(s) you select may be implemented using financial planning software tools developed by Waddell & Reed or third parties.
2. **Asset Allocation Tools:** Asset allocation tools may assist you in determining if you have an appropriate mix of investments for your personal situation. Development of a personalized asset allocation is designed to assist you in positioning your assets, based on your financial objectives, time horizons and risk tolerance. You may receive a report that contains hypothetical illustrations using assumed rates of return that are based on information you have provided to your Financial Advisor and from sources you deem to be reliable. Depicted rates of return are not representative of the actual rate of return that you will experience with any particular insurance or investment product. Such illustrations may be based on the concepts of Modern Portfolio Theory, which states that through diversification you may be able to minimize the effects of investment risks and that gains in one investment class may help offset losses in another. There is no certainty that any investment or strategy will be profitable or successful in achieving your specific investment objectives. Principal values of your investments will fluctuate and, when redeemed, may be worth more or less than your original investment. Asset allocation does not ensure a profit or protect against losses in a declining market.

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

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

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

3. **Monte Carlo Engine:** Your Financial Advisor may use a tool with a Monte Carlo simulation engine. Monte Carlo engines are based on different assumptions that lead to varying probabilities of success among various investment scenarios. When interpreting your probability of success, it is important to review the underlying



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

## C. Other Advisory Services

**In addition to Financial Planning, Waddell & Reed offers fee-based asset allocation and wrap fee programs. These investment programs are tailored to your individual needs and allow your Financial Advisor to enter into a fee-based arrangement to manage your assets for you. These fee-based asset allocation and wrap fee programs are described in significant detail in separate advisory services brochures. Please ask your Financial Advisor for these advisory services brochures if you are interested in engaging in an investment advisory relationship wherein your Financial Advisor would actively manage your financial assets. The financial planning fee is generally a separate fee which may be paid prior to investing in an asset allocation and/or wrap fee program. Certain fee-based asset allocation and/or wrap fee programs may be inclusive of certain financial planning services at no additional charge.**

## FEES AND COMPENSATION

### Negotiable Fees:

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

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

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

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

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

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

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

Service	Maximum Fee
<b>Financial Planning Service</b>	
<b>Basic Complexity</b>	<b>\$2,500</b>
<b>Intermediate Complexity</b>	<b>\$5,000</b>
<b>Advanced Complexity</b>	<b>\$10,000</b>
<b>Premier Financial Planning Service</b>	<b>\$15,000</b>

The minimum fee for the Premier Financial Planning Service is \$3,000.

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

## Fee Payment

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

## Method of Payment and Refunds

Fees may be withdrawn directly from certain Waddell & Reed mutual fund accounts, paid by a credit card approved by Waddell & Reed, or paid by check payable to Waddell & Reed. Checks may not be made payable to your Financial Advisor or to any entity other than Waddell & Reed. Fees may not be withdrawn from accounts where such withdrawal would result in a tax penalty, accounts which contain class B and C shares where such withdrawal would cause a CDSC, accounts with non-NAV A shares that have been held less than three (3) years, or sub accounts of variable insurance products.

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

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

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

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

### **Other Fees and Compensation**

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

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

Financial Advisors may recommend the Waddell & Reed Mutual Funds (i.e. the affiliated Mutual Funds sponsored by Waddell & Reed or one of its affiliates). The Waddell & Reed Mutual Funds your Financial Advisor recommends may charge front-end commissions or a back-end CDSC. The investment managers who manage these mutual funds and Financial Advisors are part of the same parent organization – Waddell & Reed Financial, Inc. Throughout more than 79 years of serving investors, Waddell & Reed has developed a business structure that combines both the creation and management of the Waddell & Reed Mutual Funds and their sale to retail investors through Waddell & Reed in its capacity as a registered investment advisor and/or broker-dealer and its Financial Advisors. We believe this business structure provides significant value to our clients, but also presents certain conflicts, which are discussed more fully below.

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

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

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

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

For additional information, you should review carefully the prospectus and, where applicable, statement of additional information for the particular mutual fund you are considering. The fact that your Financial Advisor may recommend the purchase of Waddell & Reed Mutual Funds and variable insurance products distributed through a Strategic Partner presents a conflict of interest and gives your Financial Advisor an incentive to recommend these products. Other investment alternatives having similar or better risk and return characteristics and lower costs may be available to you. Before purchasing investment products from your Financial Advisor you should consider that most of Waddell & Reed's revenue is generated from the sale of Mutual Funds and variable insurance products that charge commissions. Typically, this commission revenue is generated by the sale of the Waddell & Reed Mutual Funds and variable insurance products distributed through the Strategic Partners. If you wish to purchase securities in a brokerage account through your Financial

Advisor, you will be required to open a brokerage account at Pershing LLC. Waddell & Reed clears its general securities business exclusively through Pershing LLC on a fully disclosed basis. You will incur certain fees, expenses and trading costs if you conduct your Waddell & Reed brokerage business through a brokerage account maintained at Pershing LLC. You will receive a complete list of these fees, expenses and trading costs when you establish your Waddell & Reed brokerage account.

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

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

## **TYPES OF CLIENTS**

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

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

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

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

## **DISCIPLINARY INFORMATION**

On January 15, 2013, a Letter of Acceptance Waiver and Consent (No. 2011029075101) was approved by FINRA relating to the failure of the firm to deliver purchase confirmations for a period of time. The firm failed to deliver numerous purchase confirmations for mutual-fund asset-allocation products accounts (MAP), during a period, and those confirmations would have confirmed multiple mutual fund share purchases that occurred in numerous investment-advisory accounts. Although the failure to deliver purchase confirmations resulted from the actions of a third-party service provider, the firm remained responsible at all times for compliance with its obligations under all applicable securities laws and regulations. The firm's investment-advisory offerings include several MAP accounts. The firm contracts with its subsidiary to act as the transfer agent for the mutual funds that can be held in the MAP accounts and the subsidiary was obligated to send purchase confirmations on behalf of the firm to MAP-account customers. The firm's subsidiary, in turn, contracts with a third-party service provider to generate and deliver those confirmations. Until a certain date, all purchase transactions in MAP accounts resulted in the delivery of contemporaneous trade confirmations. On that date, however, the third-party service provider made a coding change to the software system that it provided to the subsidiary and other entities. The third party did not intend for the coding change to affect the MAP accounts in any way, and neither the subsidiary nor the firm requested the change. Nonetheless, one effect of the coding change was to prevent customers from receiving confirmations when cash in a MAP account was allocated to individual mutual funds. Thereafter, a MAP-account customer contacted a representative of the firm to ask why the firm was no longer issuing fund-allocation confirmations. The representative contacted the subsidiary, but did not alert the firm's compliance department of the situation. The subsidiary conducted an internal review and determined that the subsidiary's coding change had created the problem. The subsidiary also did not apprise the firm's compliance department of the situation at that time. Thereafter, the subsidiary began researching the issue and working on a solution. The subsidiaries initial work did not completely solve the problem and it implemented a second fix, which through subsequent testing verified that the problem was fully resolved. Without admitting or denying FINRA's allegations, Waddell & Reed agreed to a censure and fine of \$75,000 to settle the regulatory action.

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

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

## OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS

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

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

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

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

**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. *See* Appendix I to Form ADV Part 2 for more information about this relationship.

## CODE OF ETHICS

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

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

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

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

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

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

## BROKERAGE PRACTICES

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

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

## REVIEW OF FINANCIAL PLANNING AGREEMENTS

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

## CLIENT REFERRALS AND OTHER COMPENSATION

From time to time Waddell & Reed may enter into referral arrangements with financial institutions, such as banks and credit unions, CPAs, attorneys and certain others. These referral sources will be paid compensation either directly or indirectly to refer clients to Waddell & Reed for investment advisory services. The fee, if any, paid to referral sources will be disclosed to you in writing at the time of referral.



## **CUSTODY**

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

## **INVESTMENT DISCRETION**

We typically do not accept discretionary authority from clients to manage their securities accounts. We do exercise discretion indirectly within our MAP asset allocation programs only to the extent necessary to rebalance your portfolio periodically to remain consistent with the investment model you select. Certain advisors, who meet specific qualifications regarding training, education and experience, are granted the ability to use discretionary authority within the MAPFlex and MAPLatitude programs. This takes place when certain client situations have the need for or specifically request their advisor to manage their account in this manner. Each client must review and sign a discretionary authorization form granting the advisor this authority.

## **VOTING CLIENT SECURITIES**

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

## **FINANCIAL INFORMATION**

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

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

Consolidated Balance Sheet

December 31, 2016

(With Report of Independent Registered Public Accounting Firm  
Thereon)



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

Consolidated Balance Sheet

December 31, 2016

(With Report of Independent Registered Public Accounting Firm Thereon)



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

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

The Board of Directors  
Waddell & Reed, Inc.:

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, 2016. The consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statement based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statement referred to above presents fairly, in all material respects, the financial position of Waddell & Reed, Inc. and subsidiaries as of December 31, 2016, in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the consolidated financial statement, in 2016, the Company adopted AS 2015-02, Amendments to the Consolidation Analysis.

**KPMG LLP**

Kansas City, Missouri  
February 24, 2017

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

Consolidated Balance Sheet

December 31, 2016

(In thousands)

**Assets**

Cash and cash equivalents	\$ 344,052
Cash and cash equivalents – restricted	31,137
Investment securities	130,547
Receivables:	
Funds and separate accounts	21,246
Customers and other	120,413
Due from affiliates	7,097
Prepaid expenses and other current assets	19,216
Income taxes receivable	466
	<hr/>
Total current assets	674,174
Property and equipment, net	99,430
Deferred sales commissions, net	180
Deferred income taxes	25,994
Goodwill and identifiable intangible asset	35,095
Other non-current assets	27,379
	<hr/>
Total assets	\$ <u><u>862,252</u></u>

**Liabilities and Stockholder's Equity**

Accounts payable	\$ 23,367
Payable to investment companies for securities	53,691
Payable to third party brokers	7,603
Payable to customers	82,918
Accrued compensation	31,674
Other current liabilities	14,941
	<hr/>
Total current liabilities	214,194
Accrued pension costs	34,146
Other non-current liabilities	20,200
	<hr/>
Total liabilities	268,540
	<hr/>
Commitments and contingencies	
Redeemable noncontrolling interests	9,239
Stockholder's equity:	
Common stock, \$1.00 par value: 1,000 shares authorized, issued, and outstanding.	1
Additional paid-in capital	247,237
Retained earnings	378,831
Accumulated other comprehensive loss	(41,596)
	<hr/>
Total stockholder's equity	584,473
	<hr/>
Total liabilities, redeemable noncontrolling interests and stockholder's equity	\$ <u><u>862,252</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, 2016

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

**(a) Organization**

Waddell & Reed, Inc. (W&R Inc.), a broker-dealer and investment adviser, and subsidiaries (the Company, we, our, and us) derive revenues primarily from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors group of mutual funds (the Advisors Funds), Ivy Variable Insurance Portfolios (the Ivy VIP), Ivy Funds, which are underwritten by an affiliate, and InvestEd Portfolios (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. Our revenues are largely dependent on the total value and composition of assets under management. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact our revenues and results of operations. The Company is an indirect wholly owned subsidiary of Waddell & Reed Financial, Inc. (WDR), a publicly traded company.

The Company's underwriting agreements with the Funds, excluding the Ivy Funds, allow the Company the exclusive right to distribute redeemable shares of the Funds on a continuous basis. The Company has entered into a limited number of selling agreements authorizing third parties to offer certain of the Funds. In addition, the Company receives Rule 12b-1 asset-based service and distribution fees from certain of the Funds for purposes of advertising and marketing the shares of such funds and for providing shareholder-related services. The Company must pay certain costs associated with underwriting and distributing the Funds, 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**

The accompanying consolidated balance sheet is prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of the Company and its subsidiaries, all of which are wholly owned. All significant intercompany accounts

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

December 31, 2016

and transactions have been eliminated in consolidation. Amounts in the accompanying balance sheet and notes are rounded to the nearest thousand unless otherwise stated.

The company has evaluated subsequent events through February 24, 2017, the date that this balance sheet statement was issued and determined there are no other items to disclose.

**(c) Consolidation**

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

In accordance with financial accounting standards, we consolidate certain sponsored investment products in which we have a controlling interest or the investment product meets the criteria of a Variable Interest Entity (“VIE”) and we are deemed to be the primary beneficiary. In order to make this determination, an analysis is performed to determine if the investment product is a VIE or a Voting Interest Entity (“VOE”). Assessing if an entity is a VIE or VOE involves judgment and analysis on an entity by entity basis. Factors included in this assessment include the legal organization of the entity, the Company’s contractual involvement with the entity and any implications resulting from or associated with related parties’ involvement with the entity.

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

If an entity does not meet the criteria and is not considered a VIE, it is treated as a VOE, which is subject to traditional consolidation concepts based on ownership rights. Sponsored investments products that are considered VOEs are consolidated if we have a controlling financial interest in the

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

December 31, 2016

entity absent substantive investor rights to replace the investment manager of the entity (kick-out rights).

Prior to the fiscal year 2016, the amount of ownership of IGI funds held by the Company was determined at the SICAV entity level. During the first quarter 2016, the Company adopted ASU 2015-02, "Amendments to the Consolidation Analysis." Under ASU 2015-02, the ownership percentage and consolidation analysis of IGI funds is evaluated at each individual sub-fund.

**(d) *Use of Estimates***

GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities in the consolidated balance sheet and accompanying notes, and related disclosures of commitments and contingencies. Estimates are used for, but are not limited to depreciation and amortization, income taxes, valuation of assets, pension and postretirement obligations, and contingencies. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment. Actual results could differ from those estimates.

**(e) *Cash and Cash Equivalents***

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

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

Fair value of cash and cash equivalents, receivables, and payables approximates carrying value. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values for investment securities are based on Level 2 or Level 3 inputs detailed in Note 3.

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

Our investments are comprised of government obligations, corporate debt securities, common stock and investments in sponsored funds. Sponsored funds, which include the Funds, the IGI Funds and the LLCs, are investments we have made for both general corporate investment purposes and to provide seed capital for new investment products. The Company has classified its investments in certain sponsored funds as either equity method investments (when the Company owns between 20% and 50% of the fund) or as available for sale investments (when the Company owns less than 20% of the fund) as described in Note 3. Investments held by our broker/dealer entity or certain investments that are anticipated to be purchased and sold on a more frequent basis are classified as trading.

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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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 sponsored funds. For sponsored funds, realized gains and losses are computed using the average cost method. Substantially all of the Company's equity method investees are investment companies which record their underlying investments at fair value. Therefore, under the equity method of accounting, our share of the investee's underlying net income or loss is predominantly representative of fair value adjustments in the investments held by the equity method investee.

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 in which the issuer operates, 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.

**(h) *Property and Equipment***

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

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

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with ASC 350, "Intangibles – Goodwill and Other Topic." Internal costs capitalized are included in property and equipment, net in the consolidated balance sheets, and were \$12.9 million as of December 31, 2016. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally one to 10 years.

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

Goodwill represents the excess of cost over fair value of the identifiable net assets of acquired companies. Indefinite-lived intangible assets represent advisory and subadvisory management contracts for managed assets obtained in acquisitions. The Company considers these contracts to be

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

December 31, 2016

indefinite-lived intangible assets as they are expected to be renewed without significant cost or modification of terms. Goodwill and indefinite-lived intangible assets are tested for impairment annually or more frequently if events or circumstances indicate that the carrying value may not be recoverable. Goodwill and intangible assets require significant management estimates and judgment, including the valuation determination in connection with the initial purchase price allocation and the ongoing evaluation for impairment. Additional information related to the indefinite-lived intangible assets is included in Note 4. To determine the fair value of the Company's reporting unit, our review process uses the market and income approaches. In performing the analyses, the Company uses the best information available under the circumstances, including reasonable and supportable assumptions and projections.

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

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

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

**(k) *Deferred Sales Commissions***

We defer certain costs, principally sales commissions and related compensation, which 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 sold prior to January 1, 2014 are amortized on a straight-line basis over five years, which approximates the expected life of the shareholders' investments. Effective January 1, 2014, the Company suspended sales of Class B shares. The costs incurred at the time of the sale of Class C shares are amortized on a straight-line basis over 12 months. Prior to June 16, 2014, the costs incurred at the time of the sale of shares for certain fee-based asset allocation products were deferred and amortized on a straight-line basis, not to exceed three years. We recover deferred sales commissions and related compensation through Rule 12b-1 and other distribution fees, which are paid on the Class B and Class C shares of the Advisors Funds and Ivy Funds, along with contingent deferred sales charges ("CDSCs") paid by shareholders who redeem their shares prior to completion



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

December 31, 2016

of the specified holding period (three years for shares of certain fee-based asset allocation products sold prior to June 16, 2014, six years for a Class B share and 12 months for a Class C share), as well as through client fees paid on the asset allocation products sold prior to June 16, 2014. Effective June 16, 2014 we no longer assess a CDSC to investors upon early redemption of fee-based asset allocation products. During 2016, the amounts deferred for sales commissions and related compensation for the sale of certain fee-based asset allocation product were written-off as they related to our share class conversion from account-based, load-waived Class A shares to asset-based, institutional share classes for certain advisory products.

**(I) Revenue Recognition**

*Investment Management and Advisory Fees*

We recognize investment management fees as earned over the period in which services are rendered. We charge the Funds daily based upon average daily net assets under management in accordance with investment management agreements between the Funds and the Company. The majority of investment and/or advisory fees earned from institutional and separate accounts are charged either monthly or quarterly based upon an average of net assets under management in accordance with such investment management agreements. The Company may waive certain fees for investment management services at its discretion, or in accordance with contractual expense limitations. The Company has contractual arrangements with third parties to provide subadvisory services.

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

*Distribution, Underwriter and Service Fees*

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

Under a Rule 12b-1 service plan, the Funds may charge a maximum fee of 0.25% of the average daily net assets under management for Class B and C shares for expenses paid to broker/dealers and other sales professionals in connection with providing ongoing services to the Funds’ shareholders and/or maintaining the Funds’ shareholder accounts, with the exception of Class Y shares, which do

**WADDELL & REED, INC. AND SUBSIDIARIES**  
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December 31, 2016

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

Fee-based asset allocation revenues are charged quarterly based upon average daily net assets under management. For certain types of investment products, primarily variable annuities, distribution revenues are generally calculated based upon average daily net assets under management and are recognized monthly. Fees collected from advisors for services related to technology and errors and omissions insurance are recorded in underwriting and distribution fees on a gross basis, as the Company is the primary obligor in these arrangements.

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

Through a revenue sharing allocation agreement with affiliates, the Company receives 25 basis points on gross sales of assets and 10 basis points on average assets under management for Ivy Funds sold by our financial advisors. In addition, the Company receives revenue for providing accounting, information technology, legal, marketing, rent and other administrative services to affiliated companies.

**(m) Leases**

The Company leases office space under various leasing arrangements. Most lease agreements contain renewal options, rent escalation clauses and/or other inducements provided by the landlord. As leases expire, they are typically renewed or replaced in the ordinary course of business.

**(n) 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.

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Income tax expense is based on pre tax financial accounting income, including adjustments made for the recognition or derecognition related to uncertain tax positions. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as prescribed by ASC 740, "Income Taxes Topic." 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 on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date.

The Company recognizes tax benefits or tax shortfalls from equity awards in WDR stock granted to its employees and financial advisors (our sales force) who are independent contractors. Tax benefits are reflected as an increase to additional paid-in capital with a corresponding increase to income taxes receivable. Tax shortfalls are reflected as a decrease to additional paid-in capital with a corresponding decrease to income taxes receivable. For 2016, the excess tax benefits from share-based payments were \$2.7 million while the tax shortfalls from share-based payments were \$8.3 million.

**(2) New Accounting Guidance**

*Accounting Guidance Adopted During Fiscal Year 2016*

During the first quarter of 2016, the Company adopted Accounting Standards Update ("ASU") 2015-02, "Amendments to the Consolidation Analysis," which affects all companies required to evaluate consolidation of another entity. The Company determined that this ASU did not have a material impact on its previous consolidation analysis for its seeded investments in the Advisors and Ivy Funds and limited liability companies. This ASU did impact the consolidation analysis for its seeded investments in the IGI Funds. Prior to ASU 2015-02, the amount of ownership interest held by the Company was determined at the SICAV legal entity level. Under ASU 2015-02, the ownership percentage and consolidation analysis of the IGI Funds is evaluated at each individual sub-fund. To the extent material, the Company is required to consolidate any of its seeded investments if ownership, directly or indirectly, represents more than 50%.

*New Accounting Guidance Not Yet Adopted*

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers," which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This standard also specifies the accounting for certain costs to obtain or fulfill a contract with a customer. This ASU will supersede much of the existing revenue recognition guidance in accounting principles generally accepted in the United States and is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting

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period; early application is permitted for the first interim period within annual reporting periods beginning after December 15, 2016. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. We have evaluated our population of contracts and concluded that the adoption of this ASU will have an immaterial impact on our consolidated balance sheet and related disclosures.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities," which provides updated guidance on the recognition, measurement, presentation and disclosure of certain financial assets and financial liabilities. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are evaluating the estimated impact the adoption of this ASU will have on our consolidated balance sheet and related disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases," which increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This ASU will be presented using a modified retrospective approach, which includes a number of optional practical expedients that entities may elect to apply. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early application permitted. We are evaluating the estimated impact the adoption of this ASU will have on our consolidated balance sheet and related disclosures.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting," which requires recognition of all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement and classification of excess tax benefits along with other income tax cash flows as an operating activity; allows an entity to either estimate the number of awards that are expected to vest or account for forfeitures when they occur; and permits withholding up to the maximum statutory tax rates in the applicable jurisdictions. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, with early adoption permitted. Upon adoption of this standard on January 1, 2017, the Company will account for forfeitures when they occur. We do not expect a material impact on our consolidated balance sheet and related disclosures upon adoption of this ASU.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." The ASU changes the impairment model for most financial assets, and will require the use of an "expected loss" model for instruments measured at amortized cost. Under this model, entities will be required to estimate the lifetime expected credit loss on such instruments and record an allowance to offset the amortized cost basis of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. ASU 2016-13 is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019. We are evaluating the estimated impact the adoption of this ASU will have on our consolidated balance sheet and related disclosures.

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In October 2016, the FASB issued ASU 2016-16, “Intra Entity Transfers of Assets Other Than Inventory.” This ASU is intended to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory by requiring an entity to recognize the income tax consequences when a transfer occurs, instead of when an asset is sold to an outside party. The amendments in this ASU should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. ASU 2016-16 is effective for fiscal years, and interim periods within those fiscal years beginning after December 15, 2017, with early adoption permitted. We are evaluating the estimated impact the adoption of ASU 2016-16 will have on our consolidated balance sheet and related disclosures.

**(3) Investment Securities**

Investments at December 31, 2016 are as follows (in thousands):

Available-for-sale securities:	
Sponsored privately offered funds	\$ 570
Total available-for-sale securities	<u>570</u>
Trading securities:	
Mortgage-backed securities	13
Common stock	101
Consolidated sponsored funds	118,957
Sponsored funds	507
Total trading securities	<u>119,578</u>
Equity method securities:	
Sponsored funds	7,165
Sponsored privately offered funds	3,234
Total equity method securities	<u>10,399</u>
Total investment securities	<u>\$ 130,547</u>

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The following is a summary of the gross unrealized gains related to securities classified as available for sale at December 31, 2016:

	<u>Amortized cost</u>	<u>Unrealized gains</u>	<u>Unrealized losses</u>	<u>Fair value</u>
Sponsored privately offered funds	\$ 264	305	—	570
Total available-for-sale securities	<u>\$ 264</u>	<u>305</u>	<u>—</u>	<u>570</u>

*Sponsored funds*

The Company has classified its investments in certain sponsored funds as either equity method investments (when the Company owns between 20% and 50% of the fund) or as available for sale investments (when the Company owns less than 20% of the fund). Sponsored funds in which we hold a majority interest are consolidated in our balance sheet. Certain sub-funds of the IGI SICAV have been consolidated in our balance sheet as of December 31, 2016.

*Sponsored privately offered funds*

The Company holds voting interests in certain sponsored privately offered funds that are structured as investment companies in the legal form of LLCs. The Company held investments in these funds totaling \$3.8 million as of December 31, 2016, which is our maximum loss exposure.

During 2016, \$59.4 million in investments in IGI which had been accounted for under the equity method in prior years, were consolidated in the balance sheet. In addition, \$51.0 million of seed money was invested in IGI Funds during 2016.

Mortgage-backed securities accounted for as trading and held as of December 31, 2016 mature in 2022.

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*Consolidated sponsored funds*

The following table details the balances related to consolidated sponsored funds at December 31, 2016, as well as the Company's net interest in these funds:

Cash	\$ 6,319
Investments	118,957
Other assets	803
Other liabilities	(23)
Redeemable noncontrolling interests	<u>(9,239)</u>
Net interest in consolidated sponsored funds	<u>\$ 116,817</u>

During 2016, we consolidated the IGI Funds in which we provided initial capital at the time of the fund's formation. When we no longer have a controlling financial interest in a sponsored fund, it is deconsolidated from our balance sheet.

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

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

Assets classified as Level 2 can have a variety of observable inputs. These observable inputs are collected and utilized, primarily by an independent pricing service, in different evaluated pricing approaches depending upon the specific asset to determine a value. The fair value of municipal bonds is measured based on pricing models that take into account, among other factors, information received from market makers and broker/dealers, current trades, bid-wants lists, offerings, market movements, the callability of the bond, state of issuance and benchmark yield curves. The fair value of corporate bonds is measured using various techniques, which consider recently executed transactions in securities of the issuer or comparable issuers, market price quotations (where observable), bond spreads and fundamental data

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relating to the issuer. The fair value of equity derivatives is measured based on active market broker quotes, evaluated broker quotes and evaluated prices from vendors.

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, 2016 that are recognized in our consolidated balance sheet using fair value measurements based on the differing levels of inputs.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	<u>(In thousands)</u>			
<b>Available for sale securities:</b>				
Sponsored privately offered funds				
measured at net asset value <sup>(1)</sup>	\$ —	—	—	570
<b>Trading Securities:</b>				
Mortgage-backed securities	—	13	—	13
Common stock	101	—	—	101
Consolidated sponsored funds	84,960	33,997	—	118,957
Sponsored funds	507	—	—	507
<b>Equity Method Securities:</b> <sup>(2)</sup>				
Sponsored funds	7,165	—	—	7,165
Sponsored privately offered funds				
measured at net asset value <sup>(1)</sup>	—	—	—	3,234
Total	\$ <u>92,733</u>	<u>34,010</u>	<u>—</u>	<u>130,547</u>

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

(2) Substantially all of the Company's equity method investments are investment companies which record their underlying investments at fair value.



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

Goodwill represents the excess of purchase price over the tangible assets and the identifiable intangible asset of the acquired business. Our goodwill is not deductible for tax purposes. Goodwill and the identifiable intangible asset (all considered indefinite-lived) at December 31, 2016 are as follows (in thousands):

Goodwill	\$ 8,242
Identifiable intangible asset	26,853
	<hr/>
Total	\$ 35,095
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In 2016, the Company's annual impairment test indicated that goodwill and the identifiable intangible asset summarized in the table above were not impaired.

**(5) Property and Equipment**

A summary of property and equipment at December 31, 2016 is as follows (in thousands):

		<b>Estimated useful lives</b>
		<hr/>
Furniture and fixtures	\$ 29,481	3 – 10 years
Data processing equipment	19,092	1 – 5 years
Computer software	95,965	1 – 10 years
Equipment	20,432	2 – 26 years
Leasehold improvements	22,295	1 – 15 years
Building	11,699	1 – 30 years
Land	2,843	
	<hr/>	
Property and equipment, at cost	201,807	
Accumulated depreciation	(102,377)	
	<hr/>	
Property and equipment, net	\$ 99,430	
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At December 31, 2016, we have property and equipment under capital leases with a cost of \$1.8 million and accumulated depreciation of \$843 thousand.

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**(6) Income Taxes**

The tax effect of temporary differences that give rise to significant portions of deferred tax liabilities and deferred tax assets at December 31, 2016 is presented as follows (in thousands):

Deferred tax liabilities:	
Property and equipment	\$ (13,559)
Benefit plans	(12,657)
Identifiable intangible asset	(8,894)
Unrealized gains on investment securities	(949)
Prepaid expenses	(1,561)
Other	(57)
	<hr/>
Total gross deferred liabilities	(37,677)
	<hr/>
Deferred tax assets:	
Additional pension liability	24,733
Accrued compensation	9,766
Other accrued expenses	6,526
Nonvested stock	18,295
State net operating loss carryforwards	3,325
Federal benefit on state liabilities	1,643
Unused state tax credits	2,113
Other	551
	<hr/>
Total gross deferred assets	66,952
	<hr/>
Valuation allowance	(3,281)
	<hr/>
Net deferred tax asset	\$ 25,994
	<hr/>

As of December 31, 2016, 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 \$3.3 million at December 31, 2016. The carryforwards, if not utilized, will expire between 2017 and 2036. 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 \$3.3 million has been recorded at December 31, 2016. The Company has state tax credits of \$2.1 million as of December 31, 2016 that can be utilized in future tax years. Of these state tax credit carryforwards, \$1.9 million will expire between 2024 and 2032 if not utilized and \$0.2 million will expire in 2026 if not utilized. The Company anticipates these credits will be fully utilized prior to their expiration dates.

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The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying consolidated balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes receivable; and unrecognized tax benefits that reduce a net operating loss, similar tax loss or tax credit carryforward are presented as a reduction to noncurrent deferred income taxes.

The total amount of accrued penalties and interest related to uncertain tax positions at December 31, 2016 of \$2.1 million (\$1.7 million net of federal benefit) is included in the total unrecognized tax benefits described above.

The following table summarizes the Company's reconciliation of unrecognized tax benefits (excluding penalties and interest) for the year ended December 31, 2016 (in thousands):

	<b><u>Unrecognized tax benefits</u></b>
Balance at January 1, 2016	\$ 4,090
Increases during the year:	
Gross increases – tax positions in prior period	395
Gross increases – current period tax positions	275
Decreases during the year:	
Gross decreases – tax positions in prior period	(177)
Decreases due to settlements with taxing authorities	(3)
Decreases due to lapse of statute of limitations	(654)
Balance at December 31, 2016	<u>\$ 3,926</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 2016, the Company settled two open tax years that were undergoing audit by a state jurisdiction in which the Company operates. The Company is included in a federal audit of WDR for the 2014 tax year. Additionally, WDR is currently under audit in a state jurisdiction in which the Company participated in the filing of a combined tax return with WDR. Settlements of these audits are not anticipated to have a significant impact on reported income or loss. The 2013, 2015, and 2016 federal income tax returns are open tax years that remain subject to potential future audit. State income tax returns for all years after 2012 and, in certain states, income tax returns for 2012, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

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

The Company participates in the WDR sponsored non-contributory retirement plan (the Plan) that covers substantially all employees. Benefits payable under the Plan are based on employees' years of service and

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compensation during the final ten years of employment. WDR allocates pension expense to the Company for the Plan.

During 2016, WDR offered eligible terminated, vested Plan participants an option to elect a one-time voluntary lump sum window distribution equal to the present value of the participant's pension benefit, in settlement of all future pension benefits to which they would otherwise have been entitled. This offer was made in an effort to reduce pension obligations and ongoing annual pension expense. Payments were distributed to participants who accepted the lump sum offer from the assets of the Plan.

As of December 31, 2016, the total projected benefit obligation of the Plan is \$159.9 million for the Company. The total pension benefits liability (representing the projected benefit obligation in excess of the pension plan assets) recorded on the balance sheet at December 31, 2016 is \$32.2 million, which is included in accrued pension and postretirement costs.

The Company also participates in the WDR sponsored unfunded defined benefit postretirement medical plan (medical plan) that covered substantially all employees and Waddell & Reed advisors. The medical plan is contributory with participant contributions adjusted annually. The contributions for each year represent claims paid for medical expenses.

During 2016, WDR amended this plan to discontinue the availability of coverage for any individuals who retire after December 31, 2016. Qualified employees who retired on or before December 31, 2016 may continue to participate in retiree coverage under the plan.

Net accrued medical plan costs in the amount of \$2.4 million are recorded on the balance sheet of WDR at December 31, 2016, all of which relates to the Company. Of the Company's total liability at December 31, 2016, \$458 thousand is included in other current liabilities, while the remainder is long term in nature and is included in accrued pension costs.

**(8) Employee Savings Plan**

The Company participates in the WDR sponsored defined contribution plan that qualifies under Section 401(k) of the Internal Revenue Code to provide retirement benefits to substantially all of our employees. As allowed under Section 401(k), the plan provides tax-deferred salary deductions for eligible employees.

**(9) Uniform Net Capital Rule 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. The Company made this election and is not

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subject to the aggregate indebtedness ratio as of December 31, 2016. At December 31, 2016, the Company had net capital of \$52.6 million that was \$52.4 million in excess of its required net capital of \$250 thousand. The primary difference between net capital and stockholder's equity are the nonallowable assets, including equity in subsidiaries, that are excluded from net capital.

**(10) 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, 2016 for which instructions to reduce to possession or control had been issued as of December 31, 2016, 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, 2016, excluding items arising from "temporary lags that result from normal business operations" as permitted under Rule 15c3-3 of the Securities Exchange Act of 1934.

**(11) Share-Based Compensation**

WDR allocates expenses for nonvested shares of WDR stock to the Company that, in turn, are granted to certain key personnel of the Company under its stock incentive plans. Nonvested stock awards are valued on the date of grant, 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 expenses related to these awards.

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**(12) Lease Commitments**

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

<u>Year</u>	<u>Commitments</u> <u>(in thousands)</u>
2017	\$ 22,269
2018	17,759
2019	12,875
2020	7,859
2021	4,847
Thereafter	9,843
	<u>\$ 75,452</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 2016.

**(13) Related Party Transactions**

The current amounts due from affiliates at December 31, 2016 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, 2016 include amounts due for administrative and other services.

The amount classified as income tax receivable at December 31, 2016 consists entirely of amounts due from WDR for tax allocations.

We earn investment management fee revenues from the Advisors Funds and Ivy Funds VIP for which we also act as an investment adviser, pursuant to an investment management agreement with each Fund. In addition, we have agreements with the Advisors Funds and Ivy Funds VIP pursuant to Rule 12b-1 under the Investment Company Act of 1940, as amended, pursuant to which distribution and service fees are collected from the Advisor Funds and Ivy Funds VIP for distribution of mutual fund shares, for costs such as advertising and commissions paid to broker/dealers, and for providing ongoing services to shareholders of the Advisor Funds and Ivy Funds VIP and/or maintaining shareholder accounts. We also earn service fee revenues by providing various services to the Advisor Funds and their shareholders pursuant to a shareholder servicing agreement with each Fund and an accounting service agreement with the Advisor Funds and Ivy Funds VIP. These agreements are approved or renewed on an annual basis by each Fund's board of trustees, including a majority of the disinterested members. Funds and separate accounts receivable includes amounts due from the Funds for aforementioned services.

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

Through revenue sharing allocation agreements 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 Retail Broker-Dealer. The Company also receives 10 basis points on gross sales of assets and 10 basis points on average assets under management for separately managed account relationships established by the institutional channel.

**(14) Contingencies**

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

The Company establishes reserves for litigation and similar matters when those matters present material loss contingencies that management determines to be both probable and reasonably estimable in accordance with ASC 450, "*Contingencies Topic*." These amounts are not reduced by amounts that may be recovered under insurance or claims against third parties, but undiscounted receivables from insurers or other third parties may be accrued separately. The Company regularly revises such accruals in light of new information. The Company discloses the nature of the contingency when management believes it is reasonably possible the outcome may be significant to the Company's consolidated balance sheet and, where feasible, an estimate of the possible loss. For purposes of our litigation contingency disclosures, "significant" includes material matters as well as other items that management believes should be disclosed. Management's judgment is required related to contingent liabilities because the outcomes are difficult to predict.

In an action filed on April 18, 2016 in the District Court of Johnson County, Kansas, *Hieu Phan and Audrey Ohman v. Ivy Investment Management Company, et. al.* (Case No. I6CV02338 Div. 4), two individuals who allegedly purchased shares of certain affiliated registered investment companies (mutual funds) for which two of the Company's subsidiaries provide investment management services filed a putative derivative action on behalf of the mutual funds alleging breach of fiduciary duty and breach of contract claims relating to investments held in the affiliated mutual funds by the Company's registered investment advisor subsidiaries, the trustees of two of the Company's affiliated mutual funds, and an officer of the Company (who plaintiffs subsequently voluntarily dismissed). On behalf of the mutual funds, plaintiffs seek monetary damages and demand a jury trial. That Court has set this case for trial on July 16, 2018 through August 10, 2018, although there can be no assurance that the trial will take place on those dates. The Company denies that any of its subsidiaries breached their fiduciary duties to, or

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committed a breach of the investment management agreement with, the mutual funds at issue. To date, no discovery has taken place.

In the opinion of management, the ultimate resolution and outcome of this matter is uncertain. Given the preliminary nature of the proceedings and the Company's dispute over the merits of the claims, the Company is unable to estimate a range of reasonably possible loss, if any, that such matter may represent. While the ultimate resolution of this matter is uncertain, an adverse determination against the Company could have a material adverse impact on our business and financial condition.

**(15) Concentration of Credit Risk**

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









