

# Advisory Services

---

Financial Planning

---



## **COVER PAGE**

Waddell & Reed, Inc.  
SEC File Number: 16720  
Part 2A of Form ADV: Firm Brochure  
Financial Planning Services Brochure  
The date of this Brochure is: March 31, 2020

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

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

Waddell & Reed, Inc. is a federally registered investment advisor and a broker-dealer and member of FINRA.

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

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

Waddell & Reed, Inc.  
6300 Lamar Avenue  
Overland Park, KS 66202-4247

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

1. Updated the audited financial information.
2. Updated the values of the Firm's Total Assets Under Management.

TABLE OF CONTENTS

Cover Page ..... 3

Summary of Changes ..... 4

Table of Contents ..... 5

Advisory Business..... 6

Fees and Compensation..... 8

Performance-based fees and Side-by-Side Management ..... 10

Types of Clients ..... 10

Methods of Analysis, Investment Strategies and Risk of Loss ..... 11

Disciplinary Information ..... 12

Other Financial Industry Activities and Affiliations ..... 12

Code of Ethics, Participation of Interest in Client Transactions and Personal Trading ..... 13

Brokerage Practices..... 14

Review of Financial Planning Agreements ..... 14

Client Referrals and Other Compensation ..... 14

Custody..... 14

Investment Discretion ..... 15

Voting Client Securities ..... 15

Financial Information..... 15

## ADVISORY BUSINESS

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

### *Overview and Ownership*

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

Waddell & Reed is a wholly owned subsidiary of Waddell & Reed Financial, Inc., a publicly held company (NYSE: WDR) which provides mutual fund offerings, including:

- Ivy Funds,
- Ivy Funds VIP offered within variable insurance products provided by our strategic insurance partners (currently Minnesota Life Insurance Company and Nationwide Life Insurance Companies (collectively the "Strategic Product Providers") among other insurance product carriers, and
- Ivy InvestEd Portfolios offered within Waddell & Reed's 529 Plan.

The aforementioned offerings are collectively referred to as the "Affiliated Mutual Funds."

As needed or desired, financial advisors can offer mutual funds and other products that are not affiliated with Waddell & Reed. They may do so whenever you direct the selection of a different mutual fund, or it may be in your best interest to consider other investment options consistent with your personal and financial goals.

## 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.

Through the 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:

- 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.
- 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.
- 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.
- 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.
- Disability Income:** Analyze the potential impact of a disability on defined financial goals over specified time periods.
- 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.

**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 in creating your financial plan. 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, time horizon 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. 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 or insurance recommendations through your financial advisor or Waddell & Reed.

## **Waddell & Reed WealthLink**

Waddell & Reed has contracted with a third-party whereby Waddell & Reed may offer clients a service known as Waddell & Reed WealthLink which provides a personal financial website that allows you to view and organize your financial accounts, track and monitor your assets, liabilities, income, expenses as well as progress toward your financial goals.

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 your financial planning service 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 Waddell & Reed WealthLink, you will be provided a registration link via email, and be required to electronically review and accept the User Agreement and Terms of Use for Waddell & Reed WealthLink. By accepting the User Agreement and Terms of Use electronically, you are also authorizing Waddell & Reed to deliver its Financial Planning Advisory Brochure to you in electronic format. Waddell & Reed WealthLink may be terminated at any time, without notice, by you, your financial advisor, Waddell & Reed or third-party service provider. Termination will result in your login credentials being disabled. You will then no longer be able to access Waddell & Reed WealthLink 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 Waddell & Reed WealthLink 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 Waddell & Reed WealthLink, 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.

## **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.

## **Value of Total Assets Under Management**

As of December 31, 2019, Waddell & Reed has total assets under management in the amount of \$26,947,190,046 across all of our advisory programs. Of this amount, \$3,418,109,444 are managed using discretion.

## **FEES AND COMPENSATION**

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 in financial planning with you. All fees are negotiable between you and your financial advisor. Waddell & Reed may offer financial planning services free of charge. Your Financial Advisor is paid a percentage of the fee they charge for their services.

Fees are based primarily on 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 include:

1. Net worth
2. Investable assets
3. Annual income
4. Sources of current income
5. Financial life stage
6. Total number of financial goals
7. Time Commitment (anticipated time your financial advisor expects to spend to complete the service)

The fees charged may vary between clients, even between 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 financial advisor
- The geographic location of clients and financial advisors.



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

Service	Maximum Fee
Financial Planning Service	
Basic Complexity	\$2,500
Intermediate Complexity	\$5,000
Advanced Complexity	\$10,000

Under certain circumstances and only with prior approval from the Waddell & Reed Home Office fees for advanced complexity cases may exceed \$10,000 for the Financial Planning Service.

## Fee Payment

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

## Method of Payment and Refunds

Fees may be paid by personal or cashier's check payable to Waddell & Reed, Inc., credit card, or check issued from a direct non-qualified affiliated or unaffiliated mutual fund account or non-qualified Pershing account made payable to Waddell & Reed, Inc. Checks may not be made payable to your financial advisor or to any entity other than Waddell & Reed, Inc. Redemptions may not be made from an investment account which would result in a contingent deferred sales charge (CDSC) or non-aged A shares (must be held for at least three (3) years). Redemptions from qualified retirement plans, IRAs or variable insurance sub-accounts are not permitted under any circumstances. Waddell & Reed may accept payment for financial planning services from persons other than the recipient of the services.

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

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

## Plan Development

Your Advisor may utilize planning services offered or approved by Waddell & Reed to assist in the development of your financial plan.

## 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 and/or ETF asset allocation programs and wrap fee programs, details of which can be found in Waddell & Reed's other Advisory Services Brochures which can be obtained from your financial advisor. If you invest in one of these programs you will sign a different services agreement and pay an additional ongoing advisory fee for advice concerning the investment of your assets in one or more of these programs. Advisory fees charged in these programs are separate from, and in addition to, your financial planning fee. It is possible that you will pay a financial planning fee for a financial plan that,

among other things, recommends the use of more than one fee-based program. In case you decide to invest in a fee-based program you will pay fees for participating in each of these programs.

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

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

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

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

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

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

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

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

## **TYPES OF CLIENTS**

Waddell & Reed's Financial Planning Service is generally appropriate for individuals, married couples, domestic partners and entities looking for comprehensive advice around achieving their financial goals.

# METHODS OF ANALYSIS, INVESTMENT STRATEGIES AND RISK OF LOSS

## 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.

## Financial Planning Tools

Your financial plan will be prepared using financial planning software tools developed by Waddell & Reed or third parties.

## 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.

## 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.

Waddell & Reed typically recommends as part of its overall financial planning process that clients broadly allocate their assets among common asset classes. Recommendations may include specific investment and insurance products to implement 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 will 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.

## **DISCIPLINARY INFORMATION**

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

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

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

## **OTHER FINANCIAL INDUSTRY ACTIVITIES AND AFFILIATIONS**

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

- Equities
- Certain Municipal Securities
- Certain Commercial Paper

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

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

**Pershing LLC.** Waddell & Reed clears its brokerage business exclusively through Pershing LLC on a fully disclosed basis. Clients that establish brokerage accounts with Waddell & Reed must establish those accounts at Pershing LLC. Clients will be subject to the various account and transaction related costs and fees assessed by Pershing LLC, which may be higher than those charged by other broker-dealers for similar services. Waddell & Reed marks up certain charges imposed by Pershing LLC on the brokerage accounts to cover its costs in affecting the transactions set forth on the Brokerage Fee Schedule.

**Affiliated Mutual Funds.** Please read carefully the discussion above under “Other Fees and Compensation” regarding the conflicts of interest inherent in the relationship between Waddell & Reed and the Affiliated Mutual Funds. The investment manager for the Affiliated Mutual Funds is Ivy Investment Management Company, a wholly owned subsidiary of Waddell & Reed Financial, Inc.

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

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

**Envestnet:** Waddell & Reed has entered into an agreement with Envestnet pursuant to which Envestnet provides certain advisory, administrative and technological services to Waddell & Reed. Certain advisory programs offered by Waddell & Reed utilize Envestnet’s platform tools for account selection, account opening and on-going account servicing and management. Waddell & Reed has contracted with Envestnet to offer the GIS program, whereby clients have access to actively managed investment strategies from a roster of third-party or independent investment management firms made available on Envestnet’s platform.

**Lockwood Advisors, Inc.** Lockwood Advisors, Inc. is an affiliate of Pershing LLC. Waddell & Reed uses Lockwood Advisors, Inc. as a platform for some 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.

## CODE OF ETHICS, PARTICIPATION OR INTEREST IN CLIENT TRANSACTIONS AND PERSONAL TRADING

Waddell & Reed has adopted a Code of Ethics, which 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, 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 others, material nonpublic information.

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

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

Waddell & Reed, Inc.  
Legal Department  
Attention: Code of Ethics  
6300 Lamar Avenue  
Overland Park, KS 66202-4247

## **BROKERAGE PRACTICES**

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

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

## **REVIEW OF FINANCIAL PLANNING AGREEMENTS**

WRI's multifaceted supervisory structure includes Designated Supervising Principals ("DSP") located in various field offices ("Field DSP") and the Financial Advisors Division Office of Supervisory Jurisdiction ("FAD OSJ DSP") located in the Home Office. Field DSPs are responsible for the general day-to-day supervision of their assigned financial advisors. FAD OSJ DSPs supervise the offer and sale of certain securities products sold through financial advisors, Field DSPs and Home Office registered persons with personal production.

Financial Planning Services are reviewed by an appropriate DSP of Waddell & Reed.

## **CLIENT REFERRALS AND OTHER COMPENSATION**

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

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

## **CUSTODY**

Waddell & Reed does not maintain custody of client funds or securities or take possession of any assets as part of the Financial Planning Services. Your financial plan will be delivered to you no later than six (6) months from the date you execute your Financial Planning Services Agreement or such earlier date as you and your financial advisor agree. However, in certain circumstances, your financial plan may require more than six (6) months to complete due to the advanced complexity.

While you will not be charged \$1200 or greater, more than 6 months in advance of Waddell & Reed of providing Financial Planning Services, an audited balance sheet report is included with this brochure for your review.

## **INVESTMENT DISCRETION**

Waddell & Reed does not have discretion to manage your investments as part of your Financial Planning Services.

However, within approved advisory programs, you may grant Waddell & Reed limited discretionary trading authority over your investment advisory account. Written authorization granting this limited discretionary trading authority must be obtained from you prior to an investment advisor representative ("IAR") exercising any discretionary trading authority in your account. After your written authorization is received, Waddell & Reed will appoint and approve an IAR to utilize limited discretionary trading in your account. Waddell & Reed or the appointed IAR may not withdraw funds or securities from your account(s) without your express written permission.

## **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**  
(An Indirect Wholly Owned Subsidiary of Waddell & Reed Financial, Inc.)

Consolidated Balance Sheet

December 31, 2019

(With Report of Independent Registered Public Accounting Firm Thereon)

This consolidated balance sheet is deemed confidential pursuant to subparagraph (e)(3) of Rule 17a-5 of the Securities and Exchange Commission.





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

## Report of Independent Registered Public Accounting Firm

To the Stockholder and the Board of Directors  
Waddell & Reed, Inc.:

### *Opinion on the Consolidated Financial Statement*

We have audited the accompanying consolidated balance sheet of Waddell & Reed, Inc. and subsidiaries (the Company) as of December 31, 2019, and the related notes (collectively, the consolidated financial statement). In our opinion, the consolidated financial statement presents fairly, in all material respects, the financial position of the Company as of December 31, 2019, in conformity with U.S. generally accepted accounting principles.

### *Basis for Opinion*

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

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

**KPMG LLP**

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

Kansas City, Missouri  
February 24, 2020

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

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

Consolidated Balance Sheet

December 31, 2019

(In thousands)

**Assets**

Cash and cash equivalents	\$ 76,377
Cash and cash equivalents – restricted	74,325
Investment securities	59,371
Receivables:	
Funds and separate accounts	10,507
Customers and other	56,050
Due from affiliates	13,527
Prepaid expenses and other current assets	15,581
Total current assets	305,738
Property and equipment, net	30,113
Deferred income taxes	10,727
Goodwill and identifiable intangible asset	8,242
Other non-current assets	28,726
Total assets	<u>\$ 383,546</u>

**Liabilities and Stockholder's Equity**

Accounts payable	\$ 15,405
Payable to investment companies for securities	36,883
Payable to third party brokers	4,993
Payable to customers	84,558
Accrued compensation	35,883
Due to affiliates	199
Other current liabilities	19,483
Income taxes payable to parent	1,237
Total current liabilities	198,641
Accrued pension and postretirement costs	2,033
Other non-current liabilities	15,654
Total liabilities	216,328
Stockholder's equity:	
Common stock, \$1.00 par value: 1,000 shares authorized, issued and outstanding	1
Additional paid-in capital	179,951
Retained earnings	(13,618)
Accumulated other comprehensive loss	884
Total stockholder's equity	167,218
Total liabilities, redeemable noncontrolling interests and stockholder's equity	<u>\$ 383,546</u>

See accompanying notes to consolidated balance sheet.

This consolidated balance sheet is deemed confidential pursuant to subparagraph (e)(3) of Rule 17a-5 of the Securities and Exchange Commission.

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

Notes to Consolidated Balance Sheet

December 31, 2019

**(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 wealth management services, investment product underwriting and distribution, and shareholder services administration provided to the InvestEd Portfolios (InvestEd) ("Funds"). W&R Inc.'s wealth management services includes financial planning services and offering a variety of products to clients including fee-based asset allocation advisory products, mutual funds, general securities, 529 college savings plans, retirement plans, annuities and insurance products. The Company also derives revenues from investment product distribution and shareholder services administration provided to the Ivy Funds and Ivy Variable Insurance Portfolios ("Ivy VIP"), which are underwritten by an affiliate. The Funds, Ivy Funds and Ivy VIP operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the SEC). Services to the Funds are provided through underwriting agreements. Shareholder service fees for the Funds, Ivy Funds and Ivy VIP are provided under the 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 ("AUM") and assets under administration ("AUA"). Accordingly, fluctuations in financial markets and composition of AUM and AUA can significantly impact our revenues and results of operations. The Company is an indirect wholly owned subsidiary of Waddell & Reed Financial, Inc. ("WDR"), a publicly traded company.

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

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

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

Notes to Consolidated Balance Sheet

December 31, 2019

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

The company has evaluated subsequent events through February 24, 2020, the date that this consolidated balance sheet was issued and determined there are no other items to disclose.

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

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

**(d) *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.

**(e) *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.

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

Our investments are comprised of debt and equity securities and investments in sponsored funds. Sponsored funds, which include the Ivy Funds, 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 trading securities since the Company owns less than 20% of the fund.

For debt securities and equity securities classified as trading, unrealized holding gains and losses are included in earnings. Realized gains and losses are computed using the specific identification method

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

Notes to Consolidated Balance Sheet

December 31, 2019

for investment securities, other than sponsored funds. For sponsored funds, realized gains and losses are computed using the average cost method.

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

Property and equipment held and used 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 15 years for other equipment; and up to 15 years for leasehold improvements, determined by the lesser of the lease term or expected life. Property and equipment held for sale are carried at the lower of cost or fair value less cost to sell. No depreciation is recorded on assets held for sale.

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

Certain internal costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with Accounting Standards Codification (“ASC”) 350, “*Intangibles – Goodwill and Other Topic*.” Internal costs capitalized are included in property and equipment, net in the consolidated balance sheet, and were \$2.6 million as of December 31, 2019. Amortization begins when the software project is complete and ready for its intended use and continues over the estimated useful life, generally one to 10 years.

**(i) *Goodwill***

Goodwill represents the excess of cost over fair value of the identifiable net assets of acquired companies. Goodwill assets are tested for impairment annually or more frequently if events or circumstances indicate that the carrying value may not be recoverable. Goodwill assets require significant management estimates and judgement, including the valuation determination in connection with the initial purchase price allocation and the ongoing evaluation impairment. Additional information related to the goodwill is included in Note 4.

**(j) *Leases***

On January 1, 2019, the Company adopted ASU 2016-02, *Leases*, and related ASUs (“ASU 2016-02”), which increases transparency and comparability among organizations by establishing a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet with additional disclosures of key information about leasing arrangements. The Company applied the required modified retrospective transition approach, applying the new standard to all leases existing at the date of initial application, and elected the effective date of the ASU as its initial date of application. The new standard provides a number of optional practical expedients for transition and practical expedients for an entity’s ongoing accounting, which the Company has elected. In addition, we have elected the short-term lease recognition exemption for all leases that

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

Notes to Consolidated Balance Sheet

December 31, 2019

qualify. This means, for those leases that qualify, we will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets. The implementation of the new standard included recognition of new ROU assets and lease liabilities on our balance sheet as of January 1, 2019.

The Company has operating and finance leases for corporate and field office space and equipment. Our leases have remaining lease terms of less than one year to six years, some of which include options to extend leases for up to 20 years, and some of which include options to terminate the leases within one year. Certain leases include variable lease payments in future periods based on a market index or rate. We determine if an arrangement is a lease at inception (or the effective date of ASU 2016-02). Operating lease assets and liabilities are included in other non-current assets, other current liabilities, and other non-current liabilities in our consolidated balance sheet at December 31, 2019. Finance leases are included in property and equipment, net, other current liabilities, and other non-current liabilities in our consolidated balance sheet.

ROU assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at inception (or the effective date of ASU 2016-02) based on the present value of lease payments over the lease term. The Company uses an incremental borrowing rate based on the information available at inception (or the effective date of ASU 2016-02) in determining the present value of lease payments. The operating lease ROU assets also include any lease payments made and exclude lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option. Lease expense is recognized on a straight-line basis over the lease term. We have lease agreements with lease and non-lease components, which we have elected not to separate.

**(k) *Income Taxes***

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

Income tax expense is based on pre-tax financial accounting income, including adjustments made for the recognition or derecognition related to uncertain tax positions. The recognition or derecognition of income tax expense related to uncertain tax positions is determined under the guidance as prescribed by ASC 740, "*Income Taxes*." Deferred tax assets and liabilities are recognized for the future tax attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. A valuation allowance is recognized to reduce deferred tax assets if, based on available evidence, it is more likely than not that all or some portion of the asset will not be realized. Deferred tax assets and liabilities are measured using enacted tax

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

Notes to Consolidated Balance Sheet

December 31, 2019

rates that will be in effect when they are expected to be realized or settled. The effect on the measurement of deferred tax assets and liabilities of a change in income tax law is recognized in earnings in the period that includes the enactment date.

**(2) New Accounting Guidance**

*New Accounting Guidance Adopted*

On January 1, 2019, the Company adopted ASU 2016-02, which increases transparency and comparability among organizations by establishing a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet with additional disclosures of key information about leasing arrangements. The effect of adoption was the recognition of new ROU assets and lease liabilities of \$36.8 million on our balance sheet for our real estate and equipment leases as of January 1, 2019. See Note 1 – Summary of Significant Accounting Policies and Note 11 – Leases, for additional accounting policy information and the additional disclosures required by this ASU.

On January 1, 2019, the Company adopted ASU 2018-07, *Compensation – Stock Compensation: Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for share-based payments granted to nonemployees by aligning the accounting with the requirements for employee share-based compensation. Upon adoption of this ASU, the Company no longer revalues certain outstanding share-based awards for nonemployees, which are immaterial to our consolidated balance sheet and related disclosures.

During the second quarter of 2019, the Company early adopted ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which eliminates certain disclosure requirements for fair value measurements, requires entities to disclose new information, and modifies existing disclosure requirements. See Note 3 – Investment Securities, for the disclosures required by this ASU.

*New Accounting Guidance Not Yet Adopted*

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. The Company expects to adopt the provisions of this guidance on January 1, 2020. We have concluded that the adoption of this ASU will have an immaterial impact on our consolidated balance sheet and related disclosures.

In August 2018, FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*, which aligns the requirements for capitalizing implementation

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

Notes to Consolidated Balance Sheet

December 31, 2019

costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). This ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The Company expects to adopt the provisions of this guidance on January 1, 2020 and use the prospective adoption approach, which does not require the restatement of prior years. While we continue to assess all of the effects of adoption, we currently believe the adoption of this ASU will not have a material impact on our consolidated balance sheet as requirements under the standard are generally consistent with our current accounting for cloud computing arrangements, with the primary difference being the classification of certain information in our consolidated balance sheet and related disclosures.

In December 2019, FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, which simplifies and improves the consistent application of the accounting for income taxes by removing certain exceptions to general principles and by clarifying and amending existing guidance. This ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2020, with early adoption permitted. We are evaluating the impact the adoption of this ASU will have on our consolidated balance sheet and related disclosures.

**(3) Investment Securities**

Investments at December 31, 2019 are as follows (in thousands):

Trading securities:	
Commercial paper	988
Common stock	161
Corporate bonds	54,085
Mortgage-backed securities	4
Sponsored funds	150
U.S. Treasury bills	3,983
Total investment securities	<u>\$ 59,371</u>



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

Notes to Consolidated Balance Sheet

December 31, 2019

*Maturities of Fixed Income Securities*

Commercial paper, U.S. Treasury bills, Corporate bonds, and Mortgage-backed securities accounted for as trading securities and held as of December 31, 2019 mature as follows:

	<u>Fair Value</u>
Within one year	\$ 19,047
After one year but within five years	35,922
After 10 years	<u>4,091</u>
	<u>\$ 59,060</u>

Accounting standards establish a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of the asset. Inputs may be observable or unobservable and refer broadly to the assumptions that market participants would use in pricing the asset. An individual investment's fair value measurement is assigned a level based upon the observability of the inputs that are significant to the overall valuation. The three-level 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 carrying amounts of commercial paper are measured at amortized cost, which approximates fair value due to the short-time between purchase and expected maturity of the investments. Depending on the nature of the inputs, these investments are generally classified as Level 1 or 2 within the fair value hierarchy. U.S. Treasury bills are valued upon quoted market prices for similar assets in active markets, quoted prices for identical or similar assets that are not active and inputs other than quoted prices that are observable or corroborated by observable market data. The fair value of corporate bonds is measured using various techniques, which consider recently executed transactions in securities of the issuer or comparable issuers, market price quotations (where observable), bond spreads and fundamental data relating to the issuer.

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

Notes to Consolidated Balance Sheet

December 31, 2019

The following table summarizes our investment securities as of December 31, 2019 that are recognized in our consolidated balance sheet using fair value measurements based on the differing levels of inputs.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
	(In thousands)			
<b>Trading Securities:</b>				
Commercial paper	\$ —	988	—	988
Common stock	161	—	—	161
Corporate bonds	—	54,085	—	54,085
Mortgage-backed securities	—	4	—	4
Sponsored funds	150	—	—	150
U.S. Treasury bills	—	3,983	—	3,983
Total	<u>\$ 311</u>	<u>59,060</u>	<u>—</u>	<u>59,371</u>

**(4) Goodwill**

Goodwill represents the excess of purchase price over the fair value of the acquired business. Our goodwill is not deductible for tax purposes. Goodwill (considered indefinite-lived) at December 31, 2019 is \$8.2 million. In 2019, the Company's annual impairment test indicated that goodwill is not impaired.

**(5) Property and Equipment**

A summary of property and equipment at December 31, 2019 is as follows (in thousands):

		<u>Estimated useful lives</u>
Furniture and fixtures	\$ 19,890	3 – 10 years
Data processing equipment	16,013	1 – 5 years
Computer software	81,231	1 – 10 years
Equipment	11,983	2 – 15 years
Leasehold improvements	9,700	1 – 15 years
Building	7,490	1 – 30 years
Land	1,864	
Property and equipment, at cost	<u>148,171</u>	
Accumulated depreciation	<u>(118,058)</u>	
Property and equipment, net	<u>\$ 30,113</u>	

The fourth quarter of 2019 included asset impairment charges of \$12.8 million in connection with certain assets held for sale, including real property related to our corporate headquarters move and aviation equipment. Assets held for sale as of December 31, 2019 consist of \$3.1 million of aviation equipment,

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

Notes to Consolidated Balance Sheet

December 31, 2019

\$3.8 million of buildings and \$1.9 million of land. The Company intends to actively pursue sale of these assets at market prices as soon as reasonably possible.

**(6) Income Taxes**

The tax effect of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 2019 is presented as follows (in thousands):

Deferred tax assets:	
Operating lease liabilities	6,042
Accrued compensation	4,997
State net operating loss carryforwards	3,546
Other accrued expenses	2,550
Unused state tax credits	2,312
Share-based compensation	1,623
Property and equipment	\$ 1,317
Other	570
	<hr/>
Total gross deferred tax assets	22,957
Deferred tax liabilities:	
Operating lease right-of-use assets	\$ (5,630)
Prepaid expenses	(2,017)
Other	(247)
	<hr/>
Total gross deferred tax liabilities	(7,894)
Valuation allowance	(4,336)
	<hr/>
Net deferred tax asset	\$ 10,727
	<hr/>

As of December 31, 2019, 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 \$3.5 million at December 31, 2019. The carryforwards, if not utilized, will expire between 2020 and 2039. 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 \$3.5 million has been recorded at December 31, 2019. The Company has state tax credits of \$2.3 million as of December 31, 2019 that can be utilized in future tax years. Of these state tax credit carryforwards, \$2.1 million will expire between 2024 and 2034 if not utilized and \$0.2 million will expire in 2026 if not utilized. During 2019, management determined that it is not more likely than not that it will fully utilize some of these state tax credits before they expire and, accordingly, a valuation allowance in the amount of \$0.8 million has been recorded as of December 31, 2019.

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

Notes to Consolidated Balance Sheet

December 31, 2019

As of December 31, 2019, the Company had unrecognized tax benefits, including penalties and interest, of \$0.7 million (\$0.6 million net of federal benefit) that, if recognized, would impact the Company's effective tax rate. The unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other liabilities in the accompanying consolidated balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes receivable; 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 following table summarizes the Company's reconciliation of unrecognized tax benefits (excluding penalties and interest) for the year ended December 31, 2019 (in thousands):

Balance at beginning of year	\$ 934
Increases during the year:	
Gross increases – tax positions in prior period	49
Gross increases – current period tax positions	4
Decreases during the year:	
Decreases due to settlements with taxing authorities	(177)
Decreases due to lapse of statute of limitations	(176)
Gross decreases – tax positions in prior period	(23)
Balance at end of year	<u>\$ 611</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. The Company does not expect the resolution or settlement of any open audits, Federal or State, to materially impact its consolidated balance sheet. The 2016-2019 federal income tax returns are open tax years that remain subject to potential future audit. State income tax returns for all years after 2015 and, in certain states, income tax returns for 2015, 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**

Benefits payable under the Plan are based on employees' years of service and compensation during the final ten years of employment. The Compensation Committee of the Company's Board of Directors ("Compensation Committee") approved an amendment to freeze the Pension Plan effective September 30, 2017. After September 30, 2017, participants in the Pension Plan ceased accruing additional benefits for future service or compensation. Participants will retain benefits accumulated as of September 30, 2017 in accordance with the terms of the Pension Plan. In accordance with applicable accounting standards, the Pension Plan's assets and liabilities were remeasured as of July 31, 2017, the date participants were notified of the freeze.

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

Notes to Consolidated Balance Sheet

December 31, 2019

As of December 31, 2019, the total projected benefit obligation of the Plan is \$186.5 million, of which \$121.7 million relates to the Company. The total pension benefits liability (representing the projected benefit obligation in excess of pension plan assets) at December 31, 2019 is \$1.7 million and is included in Accrued pension and postretirement costs on the Company's balance sheet.

The Compensation Committee approved the termination of the Pension Plan, effective June 1, 2019, and the Company intends to terminate the Pension Plan in a standard termination, as defined by the Pension Benefit Guaranty Corporation. The Company is currently performing the administrative actions required to carry out the termination, with an expected completion date in 2020.

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

Net accrued postretirement medical plan costs in the amount of \$726 thousand are recorded on the balance sheet of WDR at December 31, 2019, of which \$453 thousand relates to the Company. Of the Company's total liability at December 31, 2019 \$129 thousand is included in other current liabilities, while the remainder is long term in nature and is included in accrued pension and postretirement costs.

**(8) Employee Savings Plan**

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

For the 2019 plan year, the Company approved a discretionary nonelective contribution in an amount equal to 2% of such participant's eligible compensation. These contributions, which were accrued during 2019, totaled \$2.1 million and will be funded and allocated to participant accounts during the first quarter of 2020.

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

Waddell & Reed, Inc. is subject to the SEC Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15.0 to 1.0. A broker-dealer may elect to not be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of Rule 15c3-1, in which case net capital must exceed the greater of \$250 thousand or 2% of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for broker-dealers. Waddell & Reed, Inc. made this election and is not subject to the aggregate indebtedness ratio as of December 31, 2019. At December 31, 2019, Waddell & Reed, Inc. had net capital of \$60.8 million that was \$60.5 million in excess of its required net capital of

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

Notes to Consolidated Balance Sheet

December 31, 2019

\$250 thousand. The primary difference between net capital and stockholder's equity are the nonallowable assets, including equity in subsidiaries, that are excluded from net capital.

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

Waddell & Reed, Inc. does not hold customer funds or safekeep customer securities and is therefore exempt from Rule 15c3-3 of the SEC under subsection (k)(2)(i) and (k)(2)(ii). Waddell & Reed, Inc. did not have any customers' fully paid securities and excess margin securities that were not in Waddell & Reed, Inc.'s possession or control as of December 31, 2019 for which instructions to reduce to possession or control had been issued as of December 31, 2019, but for which the required action was not taken by Waddell & Reed, Inc. within the time frames specified under Rule 15c3-3 of the Securities Exchange Act of 1934. Waddell & Reed, Inc. also did not have any customers' fully paid securities and excess margin securities for which instructions to reduce to possession or control had not been issued as of December 31, 2019, 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.

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

Notes to Consolidated Balance Sheet

December 31, 2019

**(11) Leases**

The Company has operating and finance leases for corporate and field office space and equipment.

Supplemental balance sheet information related to leases was as follows:

	<u>December 31, 2019</u> (in thousands, except lease term and discount rate)
<b>Operating Leases:</b>	
Operating lease ROU assets (Other non-current assets)	\$ 23,457
Other current liabilities	\$ 10,479
Other non-current liabilities	14,694
Total operating lease liabilities	<u>\$ 25,173</u>
<b>Finance Leases:</b>	
Property and equipment, gross	\$ 857
Accumulated depreciation	(658)
Property and equipment, net	<u>\$ 199</u>
Other current liabilities	\$ 176
Other non-current liabilities	33
Total finance lease liabilities	<u>\$ 209</u>
<b>Weighted average remaining lease term:</b>	
Operating leases	4 years
Finance leases	1 year
<b>Weighted average discount rate:</b>	
Operating leases	4.32%
Finance leases	6.00%

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

Notes to Consolidated Balance Sheet

December 31, 2019

Maturities of lease liabilities are as follows:

	<b>Operating Leases</b>	<b>Finance Leases</b>
	<b>(in thousands)</b>	
Year ended December 31,		
2020	\$ 11,346	179
2021	6,691	34
2022	2,178	—
2023	2,090	—
2024	2,090	—
Thereafter	2,613	—
Total lease payments	27,008	213
Less imputed interest	(1,835)	(4)
Total	<u>\$ 25,173</u>	<u>209</u>

The adoption of ASU-2016-02 using the effective date as the date of initial application requires the inclusion of the disclosures for periods prior to adoption, which are included below.

Minimum future rental commitments as of December 31, 2018 for all non-cancelable operating leases were as follows:

<b>Year</b>	<b>Commitments (in thousands)</b>
2019	\$ 16,488
2020	9,797
2021	5,757
2022	2,913
2023	2,320
Thereafter	5,161
	<u>\$ 42,436</u>

**(12) Related Party Transactions**

The current amounts due from affiliates at December 31, 2019 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, 2019 include amounts due for administrative and other services.



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

Notes to Consolidated Balance Sheet

December 31, 2019

The amount classified as income tax payable at December 31, 2019 consists entirely of amounts due to WDR for tax allocations.

**(13) Contingencies**

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

The Company 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*." 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 financial statements 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.

**(14) Concentration of Risk**

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

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





