



DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

October 31, 2006

Mr. Orrin Harrison III
Akin Gump Strauss Hauer & Feld LLP
1700 Pacific Avenue, Suite 4100
Dallas, Texas 75201-4675

Re: Waddell & Reed Financial, Inc. (FW-02708)
Waiver Request of Ineligible Issuer Status under Rule 405 of the Securities Act

Dear Mr. Harrison:

This is in response to your letter dated August 10, 2006, written on behalf of Waddell & Reed Financial, Inc. (Company) and its subsidiaries Waddell & Reed, Inc., Waddell & Reed Investment Management Company and Waddell & Reed Services Company (the "Waddell & Reed Subsidiaries") and constituting an application for relief from the Company being considered an "ineligible issuer" under Rule 405(1)(vi) of the Securities Act of 1933 (Securities Act). The Company requests relief from being considered an ineligible issuer under Rule 405, due to the entry on July 24, 2006, of a Commission Order (Order) pursuant to Sections 15(b) and Section 17A(c) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, naming the Waddell & Reed Subsidiaries as respondents.

Based on the facts and representations in your letter, and assuming the Company and the Waddell & Reed Subsidiaries will comply with the Order, the Commission, pursuant to delegated authority has determined that the Company has made a showing of good cause under Rule 405(2) and that the Company will not be considered an ineligible issuer by reason of the entry of the Order. Specifically, we determined under these facts and representations that the Company has shown that the terms of the Order were agreed to in a settlement prior to December 1, 2005. Accordingly, the relief described above from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted. Any different facts from those represented or non-compliance with the Order might require us to reach a different conclusion.

Sincerely,

Mary Kosterlitz
Chief, Office of Enforcement Liaison
Division of Corporation Finance

AKIN GUMP
STRAUSS HAUER & FELD LLP

Attorneys at Law

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oharrison@akingump.com

August 10, 2006

VIA FEDERAL EXPRESS

Mary J. Kosterlitz, Esq.
Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, NE
Mail Stop 3628
Washington, D.C. 20549

Re: *In the Matter of Waddell & Reed, Inc., et al.*

Dear Ms. Kosterlitz:

We submit this letter on behalf of Waddell & Reed Financial, Inc. ("Waddell & Reed") in connection with a settlement recently concluded arising out of the above-entitled investigation by the Securities and Exchange Commission (the "Commission"). The settlement results in the issuance of an order that is described below and attached hereto (the "Order") against Waddell & Reed, Inc., Waddell & Reed Investment Management Company, and Waddell & Reed Services Company (the "Settlement Parties"), wholly owned subsidiaries of Waddell & Reed.

Waddell & Reed hereby requests, pursuant to Rule 405 of the Securities Act of 1933 (the "Securities Act"), that the Commission determine that, for good cause shown, it is not necessary under the circumstances that Waddell & Reed be considered an "ineligible issuer" under Rule 405. Waddell & Reed requests that this determination be effective as soon as possible review can be made. It is our understanding that the Division of Enforcement does not object to the Division of Corporation Finance providing the requested determination.

BACKGROUND

The Commission and Settlement Parties reached agreement on the terms of the Order. Settlement Parties submitted an offer of settlement in which they neither admit nor deny the findings of the Order, but consented to its entry in the agreed form. The Order finds that the Settlement Parties violated Sections 206(1) and 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 17(d) of the Investment Company Act of 1940 (the "1940 Act") and Rule 17d-1 thereunder, and will direct, among other things, that the Settlement Parties (a) be censured, (b) cease and desist from committing or causing any violations and any future

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violations of Sections 206(1) and 206(2) of the Advisers Act and Section 17(d) of the 1940 Act and Rule 17d-1 thereunder, (c) pay \$50 million in disgorgement and civil money penalties, and (d) comply with its undertaking to retain a consultant to review certain compliance operations and procedures.

DISCUSSION

Waddell & Reed understands that entry of the Order could operate to make Waddell & Reed an “ineligible issuer” under Rule 405 of the Securities Act. That Rule, effective on December 1, 2005, makes available to certain issuers, referred to as “well-known seasoned issuers,” among other things, greater flexibility in registering securities through the automatic shelf registration process. Waddell & Reed, if it is not an “ineligible issuer,” would qualify as a well-known seasoned issuer and would anticipate taking advantage of the securities offering reforms reflected in the Commission’s recently-adopted rules modifying the registration, communications and offering processes under the Securities Act. See Release No. 33-8591 (July 19, 2005).

In relevant part, Rule 405 defines “ineligible issuer,” as “an issuer with respect to which any of the following is true as of the relevant dates of determination:”

- (vi) Within the past three years (but in the case of a decree or order agreed to in a settlement, not before December 1, 2005), the issuer or any entity that at the time was a subsidiary of the issuer was made the subject of any judicial or administrative decree or order arising out of a governmental action that:
 - (A) Prohibits certain conduct or activities regarding, including future violations, of, the anti-fraud provisions of the federal securities laws;
 - (B) Requires that the person cease and desist from violating the anti-fraud provisions of the federal securities laws; or
 - (C) Determines that the person violated the antifraud provisions of the federal securities laws.

Pursuant to section (2) of the definition, the Commission may determine “upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.”

Waddell & Reed requests that the Commission make this determination on the following grounds:

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1. Waddell & Reed and the staff had agreed in principle to a settlement and submitted an executed Offer of Settlement substantially prior to December 1, 2005 (the effective date of Rule 405). We understand that the Division of Enforcement concurs.

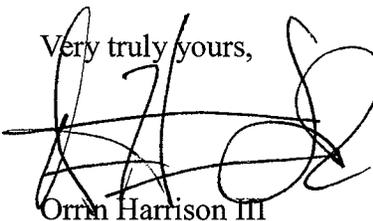
2. The staff requested nonsubstantive changes in the Offer of Settlement and Waddell & Reed agreed to submit a revised Offer of Settlement. As a result, the Order was entered by the Secretary on July 24, 2006.

3. Under such circumstances, Waddell & Reed should be treated as if it were the subject of an order agreed to in a settlement prior to December 1, 2005. Accordingly, Waddell & Reed should be determined not to be an "ineligible issuer" within the meaning of Rule 405.

In light of these considerations, there is good cause to determine that Waddell & Reed should not be considered an "ineligible issuer" under Rule 405. We respectfully request the Commission to make that determination.

Please contact me at 214-969-2860 or my corporate partner Barry Greenberg at 214-969-2707 with any questions about this request.

Very truly yours,

A handwritten signature in black ink, appearing to read "Orrin Harrison III", written over a horizontal line.

Orrin Harrison III

cc: Daniel C. Schulte
General Counsel, Waddell & Reed Financial, Inc.

Barry Greenberg
5936005

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 54193 / July 24, 2006

INVESTMENT ADVISERS ACT OF 1940

Release No. 2537 / July 24, 2006

INVESTMENT COMPANY ACT OF 1940

Release No. 27424 / July 24, 2006

ADMINISTRATIVE PROCEEDING

File No. 3-12372

In the Matter of
Waddell & Reed, Inc., Waddell & Reed
Investment Management Company, and
Waddell & Reed Services Company,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-
AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b)
AND 17A(c) OF THE SECURITIES
EXCHANGE ACT OF 1934,
SECTIONS 203(e) AND 203(k) OF
THE INVESTMENT ADVISERS ACT
OF 1940 AND SECTIONS 9(b) AND
9(f) OF THE INVESTMENT
COMPANY ACT OF 1940, MAKING
FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER

I.

The United States Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 17A(c) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Waddell & Reed, Inc. ("W&R"), Waddell & Reed

Investment Management Company (“W&R Investment Management”), and Waddell & Reed Services Company (“W&R Services”) (collectively “Respondents”).

II.

In anticipation of the institution of these proceedings, the Respondents have submitted an Offer of Settlement (the “Offer”) that the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except those findings pertaining to the jurisdiction of the Commission over the Respondents and the subject matter of these proceedings, which are admitted, the Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 17A(c) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”) as set forth below.

III.

On the basis of this Order and Respondents’ Offer, the Commission finds that:

OVERVIEW

1. Pursuant to written agreements, the Respondents permitted a number of individuals and entities (the “Market Timers” or “Timers”) to market time certain funds in the Waddell & Reed mutual fund complex (“Waddell & Reed funds”), subject to certain limitations on the number, amount and frequency of trades, from at least as early as 1995 through 2003 (“Timing Agreements”). Beginning in December 1998 and continuing through the fall of 2003, W&R Services and/or W&R collected a total of \$3.6 million in asset-based fees from three of these Timers (the “Fee Paying Timers”) pursuant to Timing Agreements with those entities. During the relevant period, Respondents had internal procedures designed to prevent or limit market timing, and the Waddell & Reed funds had prospectus disclosures that fostered the impression that the funds discouraged timing. Nevertheless, Respondents permitted the Fee Paying Timers to time certain Waddell & Reed funds, and they permitted Timers, including the Fee Paying Timers, to time in the Waddell & Reed Advisors International Growth Fund (the “International Fund”), even though they knew that the Timers were harming that fund by diluting other investors’ returns.

2. Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal per se, can harm other mutual fund shareholders, because it can dilute the value of their shares if the market timer is exploiting pricing inefficiencies. Market timing can also disrupt the management of the mutual fund’s investment portfolio, and frequent buying and selling of shares by market timers can cause the targeted mutual fund to incur costs it would not incur in the absence of the market timing.

3. The Timing Agreements benefited the Respondents financially. In addition to asset-based advisory fees that W&R Investment Management earned, W&R and/or W&R Services also received asset-based fees from the Fee Paying Timers under the Timing Agreements. Because the timing that the Respondents permitted in return for those financial benefits potentially could (and at times did) harm the funds, W&R Investment Management had a conflict of interest. It failed to disclose adequately the facts underlying that conflict to the board of directors of the mutual funds or the shareholders of the mutual funds, thereby breaching its fiduciary duty to the mutual funds.

RESPONDENTS

4. **W&R**, a Delaware corporation headquartered in Overland Park, Kansas, is a subsidiary of Waddell & Reed Financial, Inc. W&R has been dually registered with the Commission as a broker-dealer and investment adviser since 1982. During the pertinent period, W&R acted primarily as the national distributor and underwriter for shares of Waddell & Reed funds. Currently, W&R distributes the Waddell & Reed Advisors Funds, a group of the Waddell & Reed funds.

5. **W&R Investment Management**, a Kansas corporation headquartered in Overland Park, Kansas, has been registered with the Commission as an investment adviser since January 1992. During the pertinent period, W&R Investment Management, which is a subsidiary of W&R, provided investment management and advisory services to the Waddell & Reed funds, and currently it provides such services to the Waddell & Reed Advisors funds.

6. **W&R Services**, a Missouri corporation headquartered in Overland Park, Kansas, has been registered with the Commission as a transfer agent since August 1992. W&R Services, which is a subsidiary of W&R, provides transfer agent and other services to affiliated Waddell & Reed funds.

FACTS

Market Timing Agreements

7. From as early as 1995, Respondents were aware that shareholders were timing the Waddell & Reed funds, and they entered into Timing Agreements with a number of Timers. Beginning in early 2001, the Timing Agreements were executed and administered by W&R Services (and in one instance by W&R).

8. The Timing Agreements initially allowed the Timers 24 "round trip" exchanges (exchanges in and out of a fund) per fund, per year. In 1998, W&R Investment Management reduced the permitted number of round trip exchanges to 12 per fund, per year.¹

¹ One Timer was allowed 30 round trips per fund, per year.

9. W&R Investment Management also had a policy limiting aggregate assets invested in the funds by Timers to no more than 1% of the fund complex's equity assets, and no more than 2% of the assets in any one fund. Frequently, however, Timer assets exceeded 2% of the assets in one or more funds.

10. Under the Timing Agreements, Respondents permitted market timing in funds that had assets in excess of \$300 million. One of the most frequently and successfully timed funds was the International Fund, which was the fund complex's largest international fund.

11. Collectively, the timing activity by the Market Timers diluted returns to other investors in the affected Waddell & Reed funds, particularly the International Fund.

Respondents' Efforts to Control Timing Activity

12. Initially, W&R Investment Management personnel handled any monitoring of timing in the Waddell & Reed funds. Beginning in late 2000 or early 2001, however, W&R Services undertook most of the fund complex's limited efforts to monitor timing activity. Although W&R Services initially did not have any systematic means to detect timing or frequent exchanges, W&R Services personnel sometimes noticed unusual activity and followed up to determine whether the accounts were timing the funds.²

13. Beginning in mid-2001, W&R Services personnel systematically tracked known Timer accounts with monthly, and later daily, schedules reflecting Timer assets, timing capacity in individual funds, and timing capacity in the complex as a whole, and with monthly schedules that counted each Timer's round trips.

14. W&R Investment Management, and later W&R Services, generally enforced the round trip limits in the written Timing Agreements once the agreements were executed. In some instances, however, the Respondents failed to obtain written agreements from known Timers for extended periods. For example, in March 2000, the Respondents identified eleven Market Timer accounts that had not executed Timing Agreements, and they allowed six of the accounts to exceed the 12 round trip limit until they finally obtained written Timing Agreements from them in March 2002.

15. In an effort to eliminate or further limit timing in the Waddell & Reed funds, beginning at least as early as 2002, W&R Services regularly monitored and policed market timing and frequent trading in the funds through third-party platforms, and took steps to stop such trading when it was identified, including barring shareholders from the funds. At the same time it was policing market timing and frequent trading by certain accounts, W&R Services allowed certain known Market Timers, including the Fee Paying Timers, to time the funds.

² W&R Services and W&R defined Market Timers as shareholders who frequently moved all, or substantially all of their investments between money market funds and non-money market funds, and who typically executed a round trip at least once a month.

16. In May 2003, Respondents, in an effort to discourage timing, sought and obtained approval from the board of directors for all of the W&R complex international funds to assess a 2% redemption fee for redemptions or exchanges within 30 days of purchase.

Three Timers Paid Fees to W&R Services and W&R

17. Beginning in December 1998 and continuing through 2003, three Timers paid a total of \$3.6 million in fees to W&R Services and/or W&R pursuant to Timing Agreements with those entities. The Timing Agreements required the Fee Paying Timers to pay W&R or W&R Services a fee ranging from 25 to 100 basis points on the timing assets, purportedly as payment for services.³ None of the fees were paid to the timed funds. In aggregate, the Fee Paying Timers netted \$8.2 million in profits from their trading in Waddell & Reed funds under the Timing Agreements.

The Largest Fee Paying Timer

18. The largest Fee Paying Timer ("Timer 1"), which was an investment adviser, had a Timing Agreement relating to the Waddell & Reed funds from at least as early as 1995. In the fall of 1998, W&R Investment Management notified Timers with which it had Timing Agreements that round trips would be limited to 12 per fund, per year, and that this limitation also applied to the money market fund. Timer 1 proposed an alternative arrangement, which allowed unlimited round trips in the money market fund and 12 round trips per fund, per year in the other funds, and offered to pay a 1% fee based on the assets its clients held at the Waddell & Reed fund family "to defray possible fund expenses."

19. Subsequently, Timer 1 entered into a "Supplemental Services Agreement" with W&R Services, in which it agreed that its clients would pay W&R Services a 1% annual fee, and W&R Services agreed to fax confirmations to Timer 1; assign a non-exclusive, designated individual to process Timer 1's transactions; and provide Timer 1 with an annual consolidated report showing the holdings and value of its clients' accounts. Concurrently, W&R Investment Management agreed to allow Timer 1's clients 12 round trips per year, per fund, and excluded the money market fund from this limit.

20. Between December 1998 and September 2003, the aggregate value of investments in the Waddell & Reed fund complex by clients of the Timer 1 ranged from \$51.5 million to \$85 million. During that period, clients of Timer 1 netted \$12.5 million in timing profits. Timer 1 timed 13 funds at various times, trading profitably in five funds, including the International Fund.

21. Pursuant to the Supplemental Services Agreement, clients of Timer 1 paid approximately \$3.46 million in fees in total to W&R Services from 1999 through 2003.

³ Respondents, however, provided few services to the Fee Paying Timers that they did not provide to other shareholders, and the cost of the minimal additional services was far less than the amount of fees the Fee Paying Timers paid.

The Second Fee Paying Timer

22. In February 2001 and November 2002, W&R Services entered into Timing Agreements with a second investment adviser (“Timer 2”) that allowed the Timer to make up to 30 round trips per fund, per year in its client accounts.

23. Timer 2 approached the fund complex, asked for timing capacity, and agreed to pay W&R Services an annual fee of 25 basis points on its assets at Waddell & Reed funds. Timer 2 paid a total of \$139,000 in fees pursuant to its Timing Agreements.

24. At times during 2001 and 2002, the aggregate amount of assets being timed by Timer 2’s clients pursuant to the Timing Agreements rose as high as \$35 million in five Waddell & Reed funds, and Timer 2’s clients timed approximately \$3 million in the International Fund in 2002 and 2003.

25. Timer 2’s clients experienced net losses of \$6.36 million from timing in the Waddell & Reed funds overall. In the International Fund, however, clients of Timer 2 made approximately \$700,000 in net profits.

The Broker-Dealer Fee Paying Timer

26. In May 2002, W&R entered into a “selling agreement” with a broker-dealer (“Timer 3”), under the terms of which the broker-dealer paid a 25 basis point fee on assets invested in the fund complex. Under the “selling agreement,” W&R allowed Timer 3’s customers 12 round trips per year in the International Fund and a money market fund.⁴ In contrast, during this period, W&R Services policed frequent trading in the Waddell & Reed funds through other broker-dealers and took steps to stop investors from timing through broker-dealers other than Timer 3.

27. During June through November 2002, Timer 3’s customers timed approximately \$20-\$22 million in the International Fund, until W&R notified Timer 3 in late 2002 that it could no longer time the International Fund.

28. During February through April 2003, W&R and W&R Services allowed Timer 3 to time four other Waddell & Reed Advisors funds, until its customers withdrew their assets from the Waddell & Reed fund complex in April 2003.

29. Timer 3’s customers made approximately \$2.03 million in profits from their timing trades in Waddell & Reed Advisors funds, \$1.5 million of which resulted from trades in the International Fund.

⁴ During negotiations leading up to the agreement, Timer 3 asked for additional round trips and offered W&R incentives, including sticky assets (*i.e.*, long-term investments) and separate managed accounts, but Respondents declined.

30. Timer 3 paid W&R Services \$35,000 in fees in total under the “selling agreement.”

Timers Harmed the International Fund

31. In 2001, a W&R Services employee began watching for large exchanges between the International Fund and a money market fund because, among other things, he was concerned that large, frequent exchanges in the fund harmed it through dilution.

32. The employee monitored large exchange activity in the fund. In late June 2001, he prepared a schedule showing that, from April 2001 through mid-June 2001, certain known Timers had made almost \$600,000 from trading in the International Fund, while the fund’s net asset value (“NAV”) fluctuated, but ultimately experienced a net decline of \$0.24 per share. Through October 2001, the employee continued to monitor large exchange activity in the fund, and he shared with his superiors his analyses, which showed millions in profits for the Timers while the fund’s NAV per share continued to decline.

33. Despite the employee’s warnings, Respondents allowed known Timers, including Fee Paying Timers, to time in the International Fund through the fall of 2002. Respondents allowed three Timers, who were identified as such by March 2000, to make over 40 round trips in the International Fund in 2001.⁵

34. After learning that Timers were profiting in the International Fund, W&R and W&R Services entered into additional Timing Agreements. In fact, in May 2002, W&R entered into an agreement allowing customers of Timer 3 to time between the International Fund and a money market fund.

35. In early October 2002, when Timers, including Timer 3, had approximately \$40 million in the International Fund and briefly raised Timer assets to over 5% of the fund’s assets, Respondents decided to prohibit timing activity in the complex’s international funds. Thereafter, the International Fund was closed to Timers, other than Timer 2, which was allowed to continue timing in the fund through September 2003.

36. From March 2001 through September 2003, known Timers, including Fee Paying Timers, netted approximately \$11.7 million from timing in the International Fund.

⁵ W&R Investment Management testified that they believed that timing could be accretive or dilutive to the funds and that the timing parameters it put into place would limit disruption to fund portfolio managers.

**Respondents Failed to Disclose Fees Paid by Timers
or Harmful Timing in the International Fund
to the Fund Board or Shareholders**

37. Before October 2001, the registration statements and prospectuses for the Waddell & Reed funds did not contain any disclosures relating to market timing. Beginning in October 2001, the SAI for the Waddell & Reed funds, which is incorporated in the fund prospectuses and included in the registration statements, disclosed that “[t]he Fund may limit activity deemed to be market timing by restricting the amount of exchanges permitted by a shareholder.”

38. During the pertinent period, W&R marketed the Waddell & Reed Advisors Funds almost exclusively through the W&R sales force, although it was seeking to increase distribution of other Waddell & Reed funds through third party platforms. Marketing materials for the Waddell & Reed funds, available on the company website, identify one of the firm’s basic concepts as looking for investment results with a long-term perspective. The International Fund prospectus specifically states that the fund is “designed for investors seeking long-term appreciation of capital” through investment in securities issued by foreign companies.

39. None of the Waddell & Reed fund registration statements or fund prospectuses disclosed that Respondents allowed three Fee Paying Timers access to the funds in return for fees paid to W&R and W&R Services, or that Respondents allowed the Fee Paying Timers, as well as other known Timers, to time the International Fund even though the adviser and its affiliates had been notified that Timers were harming the fund through dilution.

40. Respondents did not fully disclose to the fund board of directors the facts and circumstances of the Timing Agreements with Timer 1, and did not disclose to the board the other two arrangements with Fee Paying Timers.

41. During two board meetings in late 1998 and 1999, Respondents mentioned that W&R Services might receive, or was receiving, fees under an arrangement with Timer 1. The Respondents failed to disclose fully, however, the underlying facts and circumstances of the arrangement, including that the arrangement benefited Respondents but could harm other fund shareholders, and that the Timing Agreement with Timer 1 specifically permitted more than 12 round trips in the money market fund, while Timing Agreements with other, non-fee paying Timers did not include such a provision. In subsequent board meetings, Respondents completely failed to disclose the other two fee paying arrangements. Thus, Respondents failed to disclose adequately fee paying arrangements that created conflicts of interest. W&R Investment Management therefore breached its fiduciary duty to the fund boards of directors and the funds that the Fee paying Timers timed, and defrauded shareholders of those funds.

42. Respondents did not disclose to the International Fund’s board of directors that they allowed the Fee Paying Timers, as well as other known Timers, to time the fund even though they had been notified that Timers were harming the fund through dilution of other

investors' returns. W&R Investment Management therefore breached its fiduciary duty to the International Fund board of directors and shareholders, and defrauded shareholders of that fund.

43. During a May 2003 board meeting, at which the Waddell & Reed funds boards adopted a redemption fee for the Waddell & Reed international funds, Respondents described the negative impact of Market Timers on the international funds, principally through dilution, and told the board that all redemption fees would be paid to the funds, not to Respondents. The Respondents failed to disclose, however, that, from mid-2001 through October 2002, they had allowed known Timers, including the Fee Paying Timers, to time the International Fund even though they had been notified that the Timers were harming the fund through dilution. The Respondents also failed to disclose to the fund board that W&R Services and W&R already were receiving fees from three Fee Paying Timers, two of whom were timing the International Fund. They also failed to disclose that they would continue to allow Timer 2 to time the International Fund.

VIOLATIONS

44. As a result of the conduct described in Section III. above, W&R Investment Management willfully violated Sections 206(1) and 206(2) of the Advisers Act in that, while acting as an investment adviser, it employed devices, schemes, or artifices to defraud clients or prospective clients, and engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon clients or prospective clients. Specifically, W&R Investment Management allowed Fee Paying Timers to time certain Waddell & Reed funds in a manner that it knew or had reason to believe would be harmful to shareholders in exchange for fees paid to W&R Services and W&R, and it allowed the Fee Paying Timers to time the International Fund despite having been notified that Timers were harming the fund through dilution. These actions created a conflict of interest that W&R Investment Management knowingly or recklessly failed to disclose to the board of directors and shareholders of the funds.

45. As a result of the conduct described in Section III. above, W&R and W&R Services willfully aided and abetted and caused W&R Investment Management's violations of Sections 206(1) and 206(2). W&R and W&R Services knowingly and substantially assisted W&R Investment Management's violations by negotiating Timing Agreements, from which they financially benefited, that caused W&R Investment Management to breach its fiduciary duty to the funds' board and defraud the funds' shareholders.

46. As a result of the conduct described above, Respondents, each an affiliated person of the timed Waddell & Reed funds, willfully violated Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder, in that, while acting as a principal, each of them participated in and effected transactions in connection with joint arrangements in which the funds were participants, without filing an application with the Commission and obtaining a Commission order approving the transactions. Specifically, W&R and W&R Services received fees from three Timers in return for timing capacity in the Waddell & Reed funds, and W&R Investment Management permitted the timing which financially benefited its affiliates.

UNDERTAKINGS

47. Compliance and Ethics Oversight Structure. Each Respondent has undertaken to maintain its own compliance and ethics oversight infrastructure having the following characteristics:

- a. Each Respondent shall maintain a Code of Ethics Oversight Committee having responsibility for all matters relating to issues arising under that Respondent's Code of Ethics. The Code of Ethics Oversight Committee shall be comprised of senior executives of the Respondent's operating businesses. Each Respondent shall hold at least quarterly meetings of the Code of Ethics Oversight Committee to review violations of the Code of Ethics, as well as to consider policy matters relating to the Code of Ethics. Each Respondent shall report on issues arising under the Code of Ethics, including all violations thereof, to the Audit Committee of the Directors of the Waddell & Reed funds with such frequency as the Audit Committee may instruct, and in any event at least quarterly, provided however that any material violation shall be reported promptly.
- b. Each Respondent shall establish an Internal Compliance Controls Committee to be chaired by that Respondent's Chief Compliance Officer,⁶ which Committee shall have as its members senior executives of that Respondent's operating businesses. Notice of all meetings of the Internal Compliance Controls Committee shall be given to the independent compliance officer of the Waddell & Reed funds, who shall be invited to attend and participate in such meetings. The Internal Compliance Controls Committee shall review compliance issues throughout the business of the Respondent, endeavor to develop solutions to those issues as they may arise from time to time, and oversee implementation of those solutions. The Internal Compliance Controls Committee shall provide reports on internal compliance matters to the Audit Committee of the directors of the Waddell & Reed funds with such frequency as the independent directors of such funds may instruct, and in any event at least quarterly. Each Respondent shall also provide to its respective Audit Committee (or the board of directors if that Respondent's board does not have an Audit Committee) the same reports of the Code of Ethics Oversight Committee and the Internal Compliance Controls Committee that it provides to the Audit Committee of the Waddell & Reed funds.
- c. Each Respondent shall require that its Chief Compliance Officer or a member of his or her staff shall review compliance with the policies and procedures established to address compliance issues under the Securities Act, Exchange Act, Investment Advisers Act and Investment Company

⁶ Insofar as the Order refers to the Chief Compliance Officer, if the relevant entity does not have such an officer, the ethics officer for the entity, as described in paragraph 47(e) below, may fulfill the responsibilities of the Chief Compliance Officer specified in paragraph 47 of this Order.

Act and that any violations be reported to the Internal Compliance Controls Committee.

- d. Each Respondent shall require its Chief Compliance Officer to report to the independent directors of the Waddell & Reed funds any breach of fiduciary duty and/or the federal securities laws of which he or she becomes aware in the course of carrying out his or her duties, with such frequency as the independent directors may instruct, and in any event at least quarterly, provided however that any material breach (i.e., any breach that would be important, qualitatively or quantitatively, to a reasonable director) shall be reported promptly.
- e. Each Respondent shall establish an ethics officer to whom the Respondent's employees may convey concerns about the Respondent's business matters that they believe implicate matters of ethics, conflicts of interest or questionable practices. Each Respondent shall establish procedures to investigate matters brought to the attention of the ethics officer, and these procedures shall be presented for review and approval by the independent directors of the Waddell & Reed funds. Each Respondent shall also review matters brought to the attention of its ethics officer, along with any resolution of such matters, with the independent directors of the Waddell & Reed funds with such frequency as the independent directors of such funds may instruct.

48. Independent Compliance Consultants.

- a. Respondent W&R Investment Management shall retain, within 30 days of the date of entry of the Order, the services of an Independent Compliance Consultant ("the Adviser Consultant") not unacceptable to the staff of the Commission and a majority of the independent directors of the Waddell & Reed Advisors funds. The Adviser Consultant's compensation and expenses shall be borne exclusively by W&R Investment Management or its affiliates. W&R Investment Management shall require that the Adviser Consultant shall conduct a comprehensive review of W&R Investment Management's supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by W&R Investment Management and its employees. This review shall include, but shall not be limited to, a review of W&R Investment Management's market timing controls across all areas of its business, a review of the pricing practices of the Waddell & Reed funds that may make those funds vulnerable to market timing, a review of the Waddell & Reed funds' utilization of short term trading fees and other controls for deterring excessive short term trading, and a review of W&R Investment Management's policies and procedures concerning conflicts of interest, including conflicts arising from advisory services to multiple clients. W&R Investment Management

shall cooperate fully with the Adviser Consultant and shall provide the Adviser Consultant with access to its files, books, records, and personnel as reasonably requested for the review.

- b. Respondent W&R shall retain, within 30 days of the date of entry of the Order, the services of an Independent Compliance Consultant (“the Distributor Consultant”) not unacceptable to the staff of the Commission and a majority of the independent directors of the Waddell & Reed Advisors Funds. The Distributor Consultant's compensation and expenses shall be borne exclusively by W&R or its affiliates. W&R shall require that the Distributor Consultant shall conduct a comprehensive review of W&R's mutual fund sales practices, supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by W&R and its employees. W&R shall cooperate fully with the Distributor Consultant and shall provide the Distributor Consultant with access to its files, books, records, and personnel as reasonably requested for the review.
- c. Respondent W&R Services shall retain, within 30 days of the date of entry of the Order, the services of an Independent Compliance Consultant (“the Transfer Agent Consultant”) not unacceptable to the staff of the Commission and a majority of the independent directors of the funds serviced by W&R Services. The Transfer Agent Consultant's compensation and expenses shall be borne exclusively by W&R Services or its affiliates. W&R Services shall require that the Transfer Agent Consultant shall conduct a comprehensive review of W&R Services' supervisory, compliance, and other policies and procedures designed to prevent and detect breaches of fiduciary duty, breaches of the Code of Ethics and federal securities law violations by W&R Services and its employees. W&R Services shall cooperate fully with the Transfer Agent Consultant and shall provide the Transfer Agent Consultant with access to its files, books, records, and personnel as reasonably requested for the review.
- d. Respondents shall require that, at the conclusion of the review by the Adviser Consultant, the Distributor Consultant, and the Transfer Agent Consultant (collectively referred to as the Independent Compliance Consultants), which in no event shall be more than 120 days after the date of entry of the Order, the Independent Compliance Consultants shall submit a Report to the Respondents, the directors of the Waddell & Reed funds, and the staff of the Commission. Respondents shall require that the Adviser Consultant's Report address the issues described in subparagraph 48a. of these undertakings, the Distributor Consultant's Report address the issues described in subparagraph 48b. of these undertakings, and the Transfer Agent Consultant's Report address the issues described in

subparagraph 48c. of these undertakings. Respondents shall require that each report include a description of the review performed, the conclusions reached, the respective Independent Compliance Consultant's recommendations for changes in or improvements to policies and procedures of Respondents and the pertinent Waddell & Reed funds, and a procedure for implementing the recommended changes in or improvements to Respondents' policies and procedures.

- e. Respondents shall adopt all recommendations with respect to Respondents contained in the Report of the Independent Compliance Consultants; provided, however, that within 150 days after the date of entry of the Order, Respondents shall in writing advise the Independent Compliance Consultants, the directors of the Waddell & Reed funds and the staff of the Commission of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that Respondents consider unnecessary or inappropriate, Respondents need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.
- f. As to any recommendation with respect to Respondents' policies and procedures on which Respondents and the Independent Compliance Consultants do not agree, such parties shall attempt in good faith to reach an agreement within 180 days of the date of entry of the Order. In the event Respondents and the Independent Compliance Consultants are unable to agree on an alternative proposal, Respondents will abide by the determinations of the Independent Compliance Consultants.
- g. Respondents (i) shall not have the authority to terminate the Independent Compliance Consultants, without the prior written approval of the majority of independent directors and the staff of the Commission; (ii) shall compensate the Independent Compliance Consultants, and persons engaged to assist the Independent Compliance Consultants, for services rendered pursuant to the Order at their reasonable and customary rates; and, (iii) shall not be in and shall not have an attorney-client relationship with the Independent Compliance Consultants and shall not seek to invoke the attorney-client or any other doctrine or privilege to prevent the Independent Compliance Consultants from transmitting any information, reports, or documents to the directors or the Commission.
- h. Respondents shall require that the Independent Compliance Consultants, for the period of the engagement and for a period of two years from completion of the engagement, shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such.

