



July 2006

**Following are questions and answers pertaining to the recent settlements Waddell & Reed reached with the SEC, the Kansas Securities Commissioner and the New York Attorney General's office.**

**Why did Waddell & Reed enter into settlements with the SEC?**

Waddell & Reed completed settlements with the Securities and Exchange Commission concerning market timing because we believe that this is in the best interest of our company, the Waddell & Reed mutual funds and our shareholders. As the settlement indicates, we neither admit nor deny any wrongdoing. It brings the market timing investigations to a close, allowing us to move forward focusing solely on our clients and our future.

**What are the terms of the settlements?**

Waddell & Reed has agreed to pay \$50 million in restitution and penalties to the SEC. The money ultimately will be distributed to designated shareholders of the Waddell & Reed funds. We also reached an agreement with the Kansas Securities Commissioner to pay a \$2 million fine that will be designated for investor education, and reached an agreement with the New York Attorney General to reduce management fees by \$5 million per year for each of the next five years in the Waddell & Reed Advisors Funds and the W&R Target funds.

**Were fund shareholders affected by market timing?**

The SEC found that some market timers made profits in some of the funds, which may have caused dilution in those funds. As part of the settlements, Waddell & Reed and the funds' boards will appoint an independent consultant to determine the extent to which any shareholders were impacted. We expect that the settlement dollars to be distributed to fund shareholders will fully compensate them for any dilution.

We regret any adverse impact that our shareholders may have experienced as a result of market timing that occurred in the Waddell & Reed funds. We have endeavored, since the very first days of this company in 1937, to put our clients first. We expect that the settlement dollars to be distributed to fund shareholders will fully compensate them. We hope that these payments, along with our commitment to waive our fees by \$5 million per year and the improvement of our fund governance and compliance measures will strengthen our client's trust and confidence in Waddell & Reed.

**Will this settlement have a negative financial impact on the company? How can it absorb such a financial penalty?**

Although it is not inconsequential, the settlement amount is manageable financially, and the company has the balance sheet strength to absorb this while not materially impacting our business. The fee reduction agreement concerns a portion of future revenue.

**How will this affect Waddell & Reed's corporate stock?**

While any impact on our corporate stock is impossible to forecast, we feel strongly that this settlement is the right move for our company. It allows us to move forward with a solid focus on our clients and our business strategies. We believe that putting these regulatory issues behind allows us to bring all of our resources to bear on our future growth.

**If market timing is not illegal, why is the SEC taking this action?**

Market timing is a legal trading strategy that is not prohibited by the SEC or any state regulator. The practice has become more prevalent in recent years, and the SEC has undertaken a stronger and closer review. In Waddell & Reed's case, the SEC determined that some market timers made profits in some of the Waddell & Reed Advisors equity funds, and that this may have caused some dilution in those funds. Also, the SEC believed that Waddell & Reed should have made better disclosures to the directors of the Waddell & Reed mutual funds and the funds' shareholders concerning market timing activity in Waddell & Reed funds and Waddell & Reed's acceptance of service fees from some market timers.

**If market timing can at times potentially bring a negative impact to long-term investors, why did Waddell & Reed allow it to take place?**

As noted above, market timing is a legal trading strategy that is not prohibited by the SEC or any state regulator. At the time of the events alleged in the SEC order, Waddell & Reed did not believe that market timing would adversely impact fund shareholders. The SEC has never made market timing illegal, even after the many cases it has brought in the last two years.

When Waddell & Reed noticed that some timing began to occur in our mutual funds, we sought to protect shareholders by putting restrictions in place to ensure that it would not disrupt mutual fund portfolio management. These restrictions included engaging in extensive surveillance of our funds, limiting the number of trades, preventing market timing assets from exceeding 2 percent of an individual fund's assets or 1 percent of our overall equity assets, and disallowing market timing in funds with less than \$300 million in assets. We also ultimately located and eliminated market timers who did not agree to our restrictions.

The SEC order recognizes that Waddell & Reed took measures to control market timing in its funds. We believed that the restrictions we put in place would prevent disruption to the management of the funds. We also understood that market timing in mutual funds, like day-trading stocks, would result in profits for some investors and losses for others. As the Kansas Securities Commissioner's order recognizes, market timing can actually benefit a fund during a declining market. This is borne out by the fact that one of the market timers who paid service fees to Waddell & Reed actually lost more than \$6 million while trying to time the funds. Nonetheless, the SEC ultimately determined that investors in aggregate profited from timing the funds and that such profits diluted the funds. In our case, the SEC found that market timers in aggregate made more money than they lost.

**How did Waddell & Reed begin to experience market timing in the first place?**

Waddell & Reed, like many other mutual funds, began to experience market timing in the mid-1990s. Back then, like now, market timing was a legal trading strategy that neither the SEC nor any state regulator has prohibited.

We put restrictions in place to ensure that market timing would not disrupt mutual fund portfolio management. Waddell & Reed generally attempted to control market timing by engaging in extensive surveillance of our funds to locate market timers, restricting roundtrips for market timers, preventing market timing assets from exceeding 2 percent of a particular mutual fund's assets or 1 percent of the complex's equity assets, and disallowing market timing in funds which had less than \$300 million in assets.

As market timing began to proliferate in the early 2000s, we stepped up our surveillance efforts to locate and eliminate market timers from the funds who had not agreed to our restrictions. In October 2002, we closed the Waddell & Reed Advisors International Growth Fund to market timing activity, except for two

investors who had pre-existing agreements with us to limit their trading. In May 2003, to further discourage market timing, we imposed a 2 percent redemption fee, payable to the funds, for any redemptions or exchanges within 30 days of purchase in any of Waddell & Reed's international funds. More recently, in 2004, we adopted a 2 percent redemption fee for 5-day roundtrips in any Waddell & Reed fund, and enhanced fair value pricing of the funds' portfolios. Again, we believed that the restrictions we put into place would prevent disruption to the management of the mutual funds and, to that extent, the restrictions were successful. We also believed that market timing mutual funds, like day-trading stocks, would result in profits for some investors and losses for others. The SEC found that market timers made more money than they lost.

**In which specific mutual funds did market timing occur?**

The settlement relates to some of the equity funds in the Waddell & Reed Advisors fund family. The independent consultant will determine which specific funds were adversely affected. We expect that the settlement dollars to be distributed to fund shareholders will fully compensate them for any dilution.

**How will affected shareholders receive restitution, and when?**

Waddell & Reed will appoint an independent consultant to review all accounts and determine which clients were impacted. This process may take several months to complete. Individual mutual fund shareholders will be notified if they are eligible to receive any reimbursement.

**At what point in time did market timing trades take place? Have they stopped?**

Some timing occurred in the funds as early as 1995, and ended in 2003. Today, to our knowledge, we do not have anyone engaging in market timing in our funds. We have done everything we can to eliminate them. We have terminated contracts with market timers and with brokers who engaged in market timing for their clients. We closely monitor trading activity in the funds for market timing, and we will close any market timing accounts that we find. We charge a 2 percent redemption fee for short-term round trips.

**What steps has Waddell & Reed taken to discourage market timing in the future, and to ensure adequate overall compliance? Explain the fund governance changes.**

In conjunction with the settlements, we are implementing certain fund governance and compliance procedures to ensure that we are at the forefront of best practices for the industry. The procedures include:

- The boards of directors of our mutual funds have independent chairmen and at least 75 percent of their members are independent.
- We are retaining an independent compliance consultant to review our supervisory, compliance and other procedures to make sure that they are designed to detect and prevent breaches of fiduciary duty, the Company's Code of Ethics, and federal securities laws;
- We will appoint an independent distribution consultant, who will work with us to develop a plan for distributing the \$50 million paid pursuant to the settlements to fund shareholders;
- We are creating a Code of Ethics Oversight Committee, composed of our senior officers, to oversee issues arising under our Code of Ethics;
- We are also creating an Internal Compliance Controls Committee to review and develop solutions for any compliance issues.

**When do you anticipate completing the installation of the changes in fund governance called for in the settlement?**

We will start implementing the fund governance changes gradually over the next few months. We expect to complete that process by the end of 2006.

**What is “market timing,” in basic terms?**

Market timing, very generally, is a legal practice whereby traders attempt to profit from the short-term differences between the daily closing prices of a mutual fund.

Timing occurs when investors attempt to gain short-term profits buying and selling mutual fund shares. This frequent buying and selling can at times have a negative effect on the fund's long-term holders, to the extent that short-term trading causes dilution in the fund. In order to prevent this, many mutual funds may, as Waddell & Reed has done, impose a short-term trading fee upon the sale of funds that are not held for a minimum period of time. This can help transfer the short-term costs of buying and selling new shares within the fund's portfolio to those investors not planning to stay with the fund for the long-term.

**Was the performance of any specific Waddell & Reed fund affected by market timing activity?**

The SEC determined that some market timers made profits in some of the Waddell & Reed Advisors equity funds, and that this may have caused some dilution in those funds. We expect that the settlement dollars to be distributed to fund shareholders will fully compensate them for any dilution.

**Was Ivy Funds part of this settlement?**

Neither the investment manager nor the distributor of the Ivy Funds was named in this action nor was part of this settlement. Waddell & Reed is committed to being at the forefront of best practices for mutual fund governance and compliance. The settlements confirm this commitment and contain provisions to enhance fund governance and compliance, which will be implemented for all funds that Waddell & Reed manages.

**Did any portfolio managers, officers or directors time the funds?**

No, we have found no evidence that any portfolio managers, officers or directors engaged in market timing in any of the Waddell & Reed funds.

**Did Waddell & Reed allow late trading?**

No. None of the settlements contain a finding that Waddell & Reed knowingly allowed late trading.

**What about other activities that have come under regulatory scrutiny, such as directed brokerage, inappropriate entertainment expenses, and paying for shelf space?**

None of the settlements contain a finding that Waddell & Reed is involved in any such activity.

**Do you expect to announce any additional material charges or settlements related to regulatory matters?**

No. This settlement resolves these market timing investigations. We are not aware of any other material charges or settlements related to pending regulatory matters. We believe this signals the end of an orderly process that allows us to put these regulatory issues behind us and move forward. Over the last several months, we have taken steps to systematically resolve all significant regulatory issues. We are unaware of any other material regulatory matters facing the company. We are now focused squarely on the future. As we have for nearly 70 years, we will work tirelessly to prove ourselves worthy of our clients' ongoing trust and confidence.