

WADDELL & REED FINANCIAL INC
Form 10-Q
October 29, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 001-13913

WADDELL & REED FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

51-0261715
(I.R.S. Employer
Identification No.)

6300 Lamar Avenue

Overland Park, Kansas 66202

(Address, including zip code, of Registrant's principal executive offices)

(913) 236-2000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

| | |
|---|--|
| Large accelerated filer <input checked="" type="checkbox"/> | Accelerated filer <input type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No .

Shares outstanding of each of the registrant's classes of common stock as of the latest practicable date:

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Class
Class A common stock, \$.01 par value

Outstanding as of October 22, 2010
85,388,874

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Consolidated Balance Sheets

(in thousands)

| | September 30, 2010 (unaudited) | December 31, 2009 |
|--|--------------------------------------|----------------------|
| Assets: | | |
| Cash and cash equivalents | \$ 246,517 | 244,359 |
| Cash and cash equivalents - restricted | 57,036 | 72,941 |
| Investment securities | 95,539 | 70,524 |
| Receivables: | | |
| Funds and separate accounts | 25,863 | 34,948 |
| Customers and other | 95,341 | 179,100 |
| Deferred income taxes | 8,300 | 8,225 |
| Income taxes receivable | 2,320 | |
| Prepaid expenses and other current assets | 10,207 | 8,619 |
| Total current assets | 541,123 | 618,716 |
| Property and equipment, net | 70,030 | 68,171 |
| Deferred sales commissions, net | 63,948 | 64,123 |
| Goodwill and identifiable intangible assets | 221,210 | 221,210 |
| Other non-current assets | 10,368 | 11,162 |
| Total assets | \$ 906,679 | 983,382 |
| Liabilities: | | |
| Accounts payable | \$ 38,004 | 25,210 |
| Payable to investment companies for securities | 100,052 | 222,168 |
| Accrued compensation | 41,333 | 35,341 |
| Short-term debt | 189,996 | |
| Income taxes payable | | 1,044 |
| Other current liabilities | 76,861 | 76,994 |
| Total current liabilities | 446,246 | 360,757 |
| Long-term debt | | 199,984 |
| Accrued pension and postretirement costs | 23,283 | 28,731 |
| Deferred income taxes | 1,263 | 6,983 |
| Other non-current liabilities | 19,952 | 17,872 |
| Total liabilities | 490,744 | 614,327 |
| Commitments and contingencies | | |

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Stockholders' equity :

| | | |
|--|------------|-----------|
| Preferred stock-\$1.00 par value: 5,000 shares authorized; none issued | | |
| Class A Common stock-\$0.01 par value: 250,000 shares authorized; 99,701 shares issued; 85,389 shares outstanding (85,807 shares outstanding at December 31, 2009) | 997 | 997 |
| Additional paid-in capital | 198,052 | 189,900 |
| Retained earnings | 589,580 | 527,876 |
| Cost of 14,312 common shares in treasury (13,894 at December 31, 2009) | (353,680) | (328,154) |
| Accumulated other comprehensive loss | (19,014) | (21,564) |
| Total stockholders' equity | 415,935 | 369,055 |
| Total liabilities and stockholders' equity | \$ 906,679 | 983,382 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Statements of Income

(Unaudited, in thousands, except for per share data)

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|----------------|--|----------------|
| | 2010 | 2009 | 2010 | 2009 |
| Revenues: | | | | |
| Investment management fees | \$ 111,159 | 94,687 | 333,874 | 248,234 |
| Underwriting and distribution fees | 114,071 | 96,559 | 341,752 | 268,379 |
| Shareholder service fees | 29,577 | 26,730 | 88,014 | 77,663 |
| Total | 254,807 | 217,976 | 763,640 | 594,276 |
| Operating expenses: | | | | |
| Underwriting and distribution | 132,857 | 115,119 | 400,229 | 324,618 |
| Compensation and related costs (including share-based compensation of \$10,944, \$7,645, \$30,049 and \$22,541, respectively) | 36,164 | 29,275 | 103,444 | 82,373 |
| General and administrative | 16,022 | 15,106 | 48,417 | 43,022 |
| Subadvisory fees | 6,481 | 6,129 | 20,441 | 16,317 |
| Depreciation | 3,526 | 3,503 | 10,457 | 10,259 |
| Total | 195,050 | 169,132 | 582,988 | 476,589 |
| Operating income | 59,757 | 48,844 | 180,652 | 117,687 |
| Investment and other income | 3,933 | 2,316 | 3,239 | 1,385 |
| Interest expense | (3,128) | (3,153) | (9,797) | (9,452) |
| Income before provision for income taxes | 60,562 | 48,007 | 174,094 | 109,620 |
| Provision for income taxes | 20,029 | 14,594 | 63,500 | 37,367 |
| Net income | \$ 40,533 | 33,413 | 110,594 | 72,253 |
| Net income per share: | | | | |
| Basic | \$ 0.47 | 0.39 | 1.29 | 0.85 |
| Diluted | \$ 0.47 | 0.39 | 1.29 | 0.84 |
| Weighted average shares outstanding: | | | | |
| Basic | 85,438 | 85,699 | 85,683 | 85,503 |
| Diluted | 85,448 | 85,774 | 85,715 | 85,565 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Statement of Stockholders' Equity

For the Nine Months Ended September 30, 2010

(Unaudited, in thousands)

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders Equity |
|---|------------------------|------------------------|----------------------------------|----------------------|-------------------|--|---------------------------------|
| Balance at December 31, 2009 | 99,701 | \$ 997 | 189,900 | 527,876 | (328,154) | (21,564) | 369,055 |
| Net income | | | | 110,594 | | | 110,594 |
| Recognition of equity compensation | | | 30,049 | | | | 30,049 |
| Issuance of nonvested shares and other | | | (28,559) | | 28,559 | | |
| Dividends accrued, \$0.57 per share | | | | (48,890) | | | (48,890) |
| Exercise of stock options | | | 2,382 | | 7,293 | | 9,675 |
| Excess tax benefits from share-based payment arrangements | | | 4,280 | | | | 4,280 |
| Repurchase of common stock | | | | | (61,378) | | (61,378) |
| Unrealized appreciation on available for sale investment securities | | | | | | 1,709 | 1,709 |
| Valuation allowance on investment securities - deferred tax asset | | | | | | 590 | 590 |
| Reclassification for amounts included in net income | | | | | | (799) | (799) |
| Pension and postretirement benefits | | | | | | 1,050 | 1,050 |
| Balance at September 30, 2010 | 99,701 | \$ 997 | 198,052 | 589,580 | (353,680) | (19,014) | 415,935 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Statements of Comprehensive Income

(Unaudited, in thousands)

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|--------|--|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Net income | \$ 40,533 | 33,413 | 110,594 | 72,253 |
| Other comprehensive income: | | | | |
| Net unrealized appreciation of investment securities during the period, net of income taxes of \$1,917, \$1,522, \$997 and \$2,569, respectively | 3,286 | 2,634 | 1,709 | 4,471 |
| Valuation allowance on investment securities deferred tax asset during the period | 1,128 | | 590 | |
| Pension and postretirement benefits, net of income taxes of \$206, \$201, \$617 and \$550, respectively | 350 | 347 | 1,050 | 1,096 |
| Reclassification adjustments for amounts included in net income, net of income taxes of \$(143), \$(21), \$(464) and \$1,271, respectively | (247) | (35) | (799) | 2,200 |
| Comprehensive income | \$ 45,050 | 36,359 | 113,144 | 80,020 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**WADDELL & REED FINANCIAL, INC. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

(Unaudited, in thousands)

| | For the nine months ended September 30, | |
|--|--|-----------------|
| | 2010 | 2009 |
| Cash flows from operating activities: | | |
| Net income | \$ 110,594 | 72,253 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,325 | 10,129 |
| Other than temporary impairment of investments in affiliated mutual funds | | 3,686 |
| Amortization of deferred sales commissions | 44,528 | 30,445 |
| Share-based compensation | 30,049 | 22,941 |
| Excess tax benefits from share-based payment arrangements | (4,280) | (1,584) |
| Gain on sale of available-for-sale investment securities | (1,093) | (45) |
| Net purchases and sales of trading securities | (11,865) | (119) |
| Unrealized gain on trading securities | (2,879) | (3,919) |
| Loss on sale and retirement of property and equipment | 88 | 396 |
| Capital gains and dividends reinvested | (366) | (470) |
| Deferred income taxes | (6,353) | 1,246 |
| Changes in assets and liabilities: | | |
| Cash and cash equivalents - restricted | 15,905 | (32,537) |
| Receivables from funds and separate accounts | 9,085 | (180) |
| Other receivables | 83,759 | (18,752) |
| Other assets | (794) | (3,443) |
| Deferred sales commissions | (44,353) | (37,363) |
| Accounts payable and payable to investment companies | (109,322) | 39,048 |
| Other liabilities | 5,153 | 5,037 |
| Net cash provided by operating activities | \$ 128,181 | 86,769 |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale investment securities | (20,000) | (7,700) |
| Proceeds from sales and maturities of available-for-sale investment securities | 12,773 | 384 |
| Additions to property and equipment | (12,408) | (11,563) |
| Proceeds from sales of property and equipment | 5 | 516 |
| Net cash used in investing activities | \$ (19,630) | (18,363) |
| Cash flows from financing activities: | | |
| Debt repayment | (10,000) | |
| Dividends paid | (48,970) | (48,809) |
| Repurchase of common stock | (61,378) | (40,430) |
| Exercise of stock options | 9,675 | 10,222 |
| Excess tax benefits from share-based payment arrangements | 4,280 | 1,584 |
| Net cash used in financing activities | \$ (106,393) | (77,433) |
| Net increase (decrease) in cash and cash equivalents | 2,158 | (9,027) |
| Cash and cash equivalents at beginning of period | 244,359 | 210,328 |
| Cash and cash equivalents at end of period | \$ 246,517 | 201,301 |

See accompanying notes to unaudited consolidated financial statements.

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WADDELL & REED FINANCIAL, INC.

NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Significant Accounting Policies

Waddell & Reed Financial, Inc. and Subsidiaries

Waddell & Reed Financial, Inc. and subsidiaries (hereinafter referred to as the Company, we, our and us) derive revenues primarily from investment management, investment product underwriting and distribution, and shareholder services administration provided to the Waddell & Reed Advisors Group of Mutual Funds (the Advisors Funds), Ivy Funds (the Ivy Funds), Ivy Funds Variable Insurance Portfolios (the Ivy Funds VIP), and Waddell & Reed InvestEd Portfolios (InvestEd), our college savings plan (collectively, the Advisors Funds, Ivy Funds, Ivy Funds VIP and InvestEd are referred to as the Funds), and institutional and separately managed accounts. The Funds and the institutional and separately managed accounts operate under various rules and regulations set forth by the United States Securities and Exchange Commission (the SEC). Services to the Funds are provided under investment management agreements, underwriting agreements, and shareholder servicing and accounting service 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 directors/trustees and shareholders. Our revenues are largely dependent on the total value and composition of assets under management, which currently include mainly domestic and international equity securities, but also include debt securities. Accordingly, fluctuations in financial markets and composition of assets under management can significantly impact revenues and results of operations.

Basis of Presentation

We have prepared the accompanying unaudited consolidated financial statements included herein pursuant to the rules and regulations of the SEC. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures are adequate to enable a reasonable understanding of the information presented. The information in this Quarterly Report on Form 10-Q should be read in conjunction with Part I, Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K). Certain amounts in prior period financial statements have been reclassified for consistent presentation.

The accompanying unaudited consolidated financial statements have been prepared consistently with the accounting policies described in Note 2 to the consolidated financial statements included in our 2009 Form 10-K, which include the following: use of estimates, cash and cash equivalents, disclosures about fair value of financial instruments, investment securities and investments in affiliated mutual funds, property and equipment, software developed for internal use, deferred sales commissions, revenue recognition, advertising and promotion, share-based compensation, accounting for income taxes, earnings per share and derivatives and hedging activities. The Company modified its accounting policy disclosure related to goodwill and identifiable intangible assets, which is summarized in its Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010.

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In our opinion, the accompanying unaudited consolidated financial statements reflect all adjustments (consisting of only a normal and recurring nature) necessary to present fairly our financial position at September 30, 2010, the results of operations for the three and nine months ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009 in conformity with accounting principles generally accepted in the United States.

Table of Contents**2. Cash and Cash Equivalents**

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

3. Investment Securities

Investment securities at September 30, 2010 and December 31, 2009 are as follows:

| September 30, 2010 | Amortized cost | Unrealized gains (in thousands) | Unrealized losses | Fair value |
|---------------------------------------|-------------------|---------------------------------------|----------------------|------------|
| Available-for-sale securities: | | | | |
| Mortgage-backed securities | \$ 10 | 2 | | 12 |
| Municipal bonds | 4,606 | 17 | (48) | 4,575 |
| Affiliated mutual funds | 38,633 | 4,484 | (29) | 43,088 |
| | \$ 43,249 | 4,503 | (77) | 47,675 |
| Trading securities: | | | | |
| Mortgage-backed securities | | | | 74 |
| Municipal bonds | | | | 500 |
| Corporate bonds | | | | 58 |
| Common stock | | | | 29 |
| Affiliated mutual funds | | | | 47,203 |
| | | | | 47,864 |
| Total investment securities | | | | 95,539 |

| December 31, 2009 | Amortized cost | Unrealized gains (in thousands) | Unrealized losses | Fair value |
|---------------------------------------|-------------------|---------------------------------------|----------------------|------------|
| Available-for-sale securities: | | | | |
| Mortgage-backed securities | \$ 10 | 2 | | 12 |
| Municipal bonds | 4,959 | | (286) | 4,673 |
| Affiliated mutual funds | 29,817 | 3,241 | (143) | 32,915 |
| | \$ 34,786 | 3,243 | (429) | 37,600 |
| Trading securities: | | | | |
| Mortgage-backed securities | | | | 107 |
| Municipal bonds | | | | 478 |
| Corporate bonds | | | | 94 |
| Common stock | | | | 30 |
| Affiliated mutual funds | | | | 32,215 |

| | |
|-----------------------------|--------|
| | 32,924 |
| Total investment securities | 70,524 |

Purchases and sales of trading securities during the nine months ended September 30, 2010 were \$15.3 million and \$3.4 million, respectively.

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A summary of available-for-sale debt securities and affiliated mutual funds with fair values below carrying values at September 30, 2010 and December 31, 2009 is as follows:

| September 30, 2010 | Less than 12 months | | 12 months or longer | | Fair value | Total Unrealized losses |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------------|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | | |
| | | | (in thousands) | | | |
| Municipal bonds | \$ | | 2,680 | (48) | 2,680 | (48) |
| Affiliated mutual funds | | 100 | 563 | (27) | 663 | (29) |
| Total temporarily impaired securities | \$ | 100 | 3,243 | (75) | 3,343 | (77) |

| December 31, 2009 | Less than 12 months | | 12 months or longer | | Fair value | Total Unrealized losses |
|---------------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------------|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | | |
| | | | (in thousands) | | | |
| Municipal bonds | \$ | 3,843 | 830 | (161) | 4,673 | (286) |
| Affiliated mutual funds | | 11,064 | 823 | (79) | 11,887 | (143) |
| Total temporarily impaired securities | \$ | 14,907 | 1,653 | (240) | 16,560 | (429) |

Based upon our assessment of these municipal bonds and affiliated mutual funds, the time frame investments have been in a loss position, our intent to hold affiliated mutual funds until they have recovered and our history of holding bonds until maturity, we determined that a write-down was not necessary at September 30, 2010.

Mortgage-backed securities and municipal bonds accounted for as available-for-sale and held as of September 30, 2010 mature as follows:

| | Amortized cost | Fair value |
|------------------------------------|----------------|------------|
| | (in thousands) | |
| After one year but within 10 years | \$ 3,615 | 3,633 |
| After 10 years | 1,001 | 954 |
| | \$ 4,616 | 4,587 |

Mortgage-backed securities, municipal bonds and corporate bonds accounted for as trading and held as of September 30, 2010 mature as follows:

| | Fair value |
|------------------------------------|----------------|
| | (in thousands) |
| After one year but within 10 years | \$ 558 |
| After 10 years | 74 |
| | \$ 632 |

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We determine the fair value of our investments using broad levels of inputs as defined by related accounting standards as follows:

- **Level 1** Investments are valued using quoted prices in active markets for identical securities at the reporting date. Assets classified as Level 1 include affiliated mutual funds classified as available-for-sale and affiliated mutual funds and common stock classified as trading.
- **Level 2** Investments are valued using other significant observable inputs, including quoted prices in active markets for similar securities. Assets classified as Level 2 include mortgage-backed securities, municipal bonds and corporate bonds.
- **Level 3** Investments are valued using significant unobservable inputs, including the Company's own assumptions in determining the fair value of investments.

The following table summarizes our investment securities recognized on our balance sheet using fair value measurements based on the differing levels of inputs:

| | September 30, 2010 | December 31, 2009 |
|---------|-----------------------|----------------------|
| | (in thousands) | |
| Level 1 | \$ 90,320 | 65,160 |
| Level 2 | 5,219 | 5,364 |
| Level 3 | | |
| Total | \$ 95,539 | 70,524 |

4. Goodwill and Identifiable Intangible Assets

Goodwill represents the excess of purchase price over the tangible assets and identifiable intangible assets of an acquired business. Our goodwill is not deductible for tax purposes. The carrying values of goodwill and identifiable intangible assets (all considered indefinite-life) are summarized as follows:

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| | (in thousands) | |
| Goodwill | \$ 202,518 | 202,518 |
| Accumulated amortization | (36,307) | (36,307) |
| Total goodwill | 166,211 | 166,211 |
| Mutual fund management advisory contracts | 38,699 | 38,699 |
| Mutual fund subadvisory management contracts | 16,300 | 16,300 |

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| | | |
|--------------------------------------|------------|---------|
| Total identifiable intangible assets | 54,999 | 54,999 |
| Total | \$ 221,210 | 221,210 |

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5. Indebtedness

Debt is reported at its carrying amount on the consolidated balance sheet. The fair value of the Company's debt is approximately \$192.9 million as of September 30, 2010, compared to the carrying value of \$190.0 million.

During the first quarter of 2010, we repurchased \$10.0 million of our \$200.0 million aggregate principal amount 5.6% senior notes due January 2011 (the "Notes"). The retirement resulted in a loss of approximately \$400 thousand, which is included in interest expense in the statement of income. Additionally, we reclassified the Notes from long-term debt to short-term debt due to their scheduled maturity within the next 12 months.

On August 31, 2010, the Company entered into an agreement to complete a \$190.0 million private placement of Senior Notes (the "Senior Notes"). The proceeds of this debt issuance will be used to refinance the existing \$190.0 million senior notes expiring in January 2011. The Senior Notes will be unsecured and will be issued in two tranches: \$95.0 million bearing interest at 5% and maturing January 13, 2018 and \$95.0 million bearing interest of 5.75% and maturing January 13, 2021. Interest will be payable semi-annually in January and July of each year. The most restrictive provisions of the agreement will require the Company to maintain a consolidated leverage ratio not to exceed 3.0 to 1.0 for four consecutive quarters and a consolidated interest coverage ratio of not less than 4.0 to 1.0 for four consecutive quarters. The Senior Notes contain a delayed funding provision which will allow the Company to draw down the proceeds in January 2011 when the existing senior notes mature.

The Company also entered into a three year revolving credit facility (the "Credit Facility") with various lenders, effective August 31, 2010, which initially provides for borrowings of up to \$125.0 million and replaced the Company's previous revolving credit facility. Lenders could, at their option upon the Company's request, expand the facility to \$200.0 million. At September 30, 2010, there were no borrowings outstanding under the Credit Facility. Borrowings under the Credit Facility bear interest at various rates including adjusted LIBOR or an alternative base rate plus, in each case, an incremental margin based on the Company's credit rating. The Credit Facility also provides for a facility fee on the aggregate amount of commitments under the revolving facility (whether or not utilized). The facility fee is also based on the Company's credit rating level. The Credit Facility's covenants match those outlined above for the Senior Notes. The Company was in compliance with these covenants and similar covenants in prior facilities for all years presented.

6. Income Tax Uncertainties

As of January 1, 2010 and September 30, 2010, the Company had unrecognized tax benefits, including penalties and interest, of \$6.8 million (\$4.7 million net of federal benefit) and \$6.8 million (\$4.8 million net of federal benefit), respectively, that if recognized, would impact the Company's effective tax rate. Unrecognized tax benefits that are not expected to be settled within the next 12 months are included in other non-current liabilities in the consolidated balance sheet; unrecognized tax benefits that are expected to be settled within the next 12 months are included in income taxes payable.

The Company's accounting policy with respect to interest and penalties related to tax uncertainties is to classify these amounts as income taxes. As of January 1, 2010, the total amount of accrued interest and penalties related to uncertain tax positions recognized in the consolidated balance sheet was \$2.0 million (\$1.6 million net of federal benefit). The total amount of penalties and interest, net of federal benefit, related to tax

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uncertainties recognized in the statement of income for the nine month period ended September 30, 2010 was \$81 thousand. The total amount of accrued penalties and interest related to uncertain tax positions at September 30, 2010 of \$1.9 million (\$1.5 million net of federal benefit) is included in the total unrecognized tax benefits described above.

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 2007, 2008 and 2009 federal income tax returns are open

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tax years that remain subject to potential future audit. The 2005 and 2006 federal tax years also remain open to a limited extent due to capital loss carryback claims. State income tax returns for all years after 2006, and in certain states, income tax returns for 2005 and 2006, are subject to potential future audit by tax authorities in the Company's major state tax jurisdictions.

The Company is currently being audited in three state jurisdictions. It is reasonably possible that the Company will settle the audits in these jurisdictions within the next 12 month period. It is estimated that the Company's liability for unrecognized tax benefits, including penalties and interest, could decrease by approximately \$705 thousand to \$2.1 million (\$474 thousand to \$1.4 million net of federal benefit) upon settlement of these audits. Such settlements are not anticipated to have a significant impact on the results of operations.

7. Pension Plan and Postretirement Benefits Other Than Pension

We provide a non-contributory retirement plan that covers substantially all employees (the Pension Plan). Benefits payable under the Pension Plan are based on employees' years of service and compensation during the final 10 years of employment. We also sponsor an unfunded defined benefit postretirement medical plan that covers substantially all employees, including Waddell & Reed and Legend advisors. The medical plan is contributory with retiree contributions adjusted annually. The medical plan does not provide for post age 65 benefits with the exception of a small group of employees that were grandfathered when such plan was established.

The following table presents the components of net periodic pension and other postretirement costs related to these plans:

| | Pension Benefits Three months ended September 30, | | Other Postretirement Benefits Three months ended September 30, | | Pension Benefits Nine months ended September 30, | | Other Postretirement Benefits Nine months ended September 30, | |
|--|--|---------|---|------|---|---------|--|------|
| | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | | (in thousands) | | | |
| Components of net periodic benefit cost: | | | | | | | | |
| Service cost | \$ 1,535 | 1,319 | 111 | 93 | 4,605 | 3,957 | 332 | 279 |
| Interest cost | 1,649 | 1,597 | 91 | 85 | 4,947 | 4,790 | 273 | 255 |
| Expected return on plan assets | (1,875) | (1,607) | | | (5,624) | (4,821) | | |
| Actuarial loss amortization | 404 | 399 | | | 1,212 | 1,197 | | |
| Prior service cost amortization | 139 | 139 | 11 | 10 | 417 | 417 | 34 | 30 |
| Transition obligation amortization | 1 | 1 | | | 3 | 3 | | |
| Total | \$ 1,853 | 1,848 | 213 | 188 | 5,560 | 5,543 | 639 | 564 |

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During the nine months ended September 30, 2010, we made a \$10.0 million contribution to the Pension Plan. In October 2010, we made an additional \$2.5 million contribution to the Pension Plan. We do not expect to make additional contributions to the Pension Plan for the remainder of 2010.

Table of Contents**8. Stockholders Equity***Earnings per Share*

The components of basic and diluted earnings per share were as follows:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|--|--------|------------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except per share amounts) | | | |
| Net income | \$ 40,533 | 33,413 | 110,594 | 72,253 |
| Weighted average shares outstanding - basic | 85,438 | 85,699 | 85,683 | 85,503 |
| Dilutive potential shares from stock options | 10 | 75 | 32 | 62 |
| Weighted average shares outstanding - diluted | 85,448 | 85,774 | 85,715 | 85,565 |
| Earnings per share: | | | | |
| Basic | \$ 0.47 | 0.39 | 1.29 | 0.85 |
| Diluted | \$ 0.47 | 0.39 | 1.29 | 0.84 |

Anti-dilutive Securities

Options to purchase 401 thousand shares and 327 thousand shares of our common stock were excluded from the diluted earnings per share calculation for the three and nine months ended September 30, 2010, respectively, because they were anti-dilutive. Options to purchase 795 thousand shares and 866 thousand shares of common stock were excluded from the diluted earnings per share calculation for the three and nine months ended September 30, 2009, respectively, because they were anti-dilutive.

Dividends

On July 21, 2010, the Board of Directors (the Board) approved a dividend on our common stock in the amount of \$0.19 per share to stockholders of record as of October 1, 2010 to be paid on November 1, 2010. The total dividend to be paid is approximately \$16.2 million.

On October 14, 2010, the Board approved an increase in the quarterly dividend on our common stock to \$0.20 per share. The dividend is payable on February 1, 2011 to stockholders of record as of January 3, 2011.

Common Stock Repurchases

The Board has authorized the repurchase of our common stock in the open market and/or private purchases. The acquired shares may be used for corporate purposes, including shares issued to employees in our stock-based compensation programs. There were 37,087 shares and 1,916,297 shares repurchased in the open market or privately during the three and nine months ended September 30, 2010, respectively, which included 27,087 shares and 299,417 shares repurchased from employees who elected to tender shares to cover their minimum income tax withholdings with respect to the vesting of stock awards during the three and nine months ended September 30, 2010, respectively. There were 678,978 shares and 1,772,843 shares repurchased in the open market or privately during the three and nine months ended September 30, 2009, respectively, which included 6,043 shares and 256,108 shares repurchased from employees who elected to tender shares to cover their minimum income tax withholdings with respect to the vesting of stock awards during the three and nine months ended September 30, 2009, respectively.

Table of Contents**9. Share-Based Compensation**

A summary of stock option activity and related information for the nine months ended September 30, 2010 is presented in the table below. All options outstanding expire prior to December 31, 2013.

| | Options | | Weighted average exercise price |
|---------------------------------|-----------|----|---------------------------------------|
| Outstanding, December 31, 2009 | 897,503 | \$ | 30.65 |
| Granted | | | |
| Exercised | (303,870) | | 31.84 |
| Terminated/Cancelled | (127,026) | | 31.65 |
| Outstanding, September 30, 2010 | 466,607 | \$ | 29.61 |
| Exercisable, September 30, 2010 | 466,607 | \$ | 29.61 |

10. Contingencies

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

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

In this action filed December 28, 2009, the Company, along with various of its affiliates, were sued in an individual action, class action and Fair Labor Standards Act (FLSA) nationwide collective action by two former advisors asserting misclassification of financial advisors as independent contractors instead of employees. Plaintiffs assert claims under the FLSA for minimum wages and overtime wages, and under California Labor Code Statutes for timely pay wages, minimum wages, overtime compensation, meal periods, reimbursement of losses and business expenses and itemized wage statements and a claim for Unfair Business Practices under §17200 of the California Business & Professions Code. Plaintiffs seek declaratory and injunctive relief and monetary damages. The Company intends to vigorously contest plaintiffs claims.

In the opinion of management, the ultimate resolution and outcome of this matter is uncertain. At this stage of the litigation, the Company is unable to estimate the expense or exposure, if any, that it may represent. The ultimate resolution of this matter, or an adverse determination against the Company, could have a material adverse impact on the financial position and results of operations of the Company. However, this possible impact is unknown and not reasonably determinable; therefore, no liability has been recorded in the consolidated financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which reflect the current views and assumptions of management with respect to future events regarding our business and industry in general. These forward-looking statements include all statements, other than statements of historical fact, regarding our financial position, business strategy and other plans and objectives for future operations, including statements with respect to revenues and earnings, the amount and composition of assets under management, distribution sources, expense levels, redemption rates and the financial markets and other conditions. These statements are generally identified by the use of such words as may, could, should, would, believe, anticipate, forecast, estimate, expect, intend, plan, project, outlook, statements of a future or forward-looking nature. Readers are cautioned that any forward-looking information provided by or on behalf of the Company is not a guarantee of future performance. Actual results may differ materially from those contained in these forward-looking statements as a result of various factors, including but not limited to those discussed below. If one or more events related to these or other risks, contingencies or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may differ materially from those forecasted or expected. Certain important factors that could cause actual results to differ materially from our expectations are disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2009, which include, without limitation:

- *A decline in the securities markets or in the relative investment performance of our Funds and other investment portfolios and products as compared to competing funds;*

- *The introduction of legislative or regulatory proposals or judicial rulings that change the independent contractor classification of our financial advisors at the federal or state level for employment tax or other employee benefit purposes;*

- *The adverse ruling or resolution of any litigation, regulatory investigations and proceedings, or securities arbitrations by a federal or state court or regulatory body;*

- *Non-compliance with applicable laws or regulations and changes in current legal, regulatory, accounting, tax or compliance requirements or governmental policies;*

- *The loss of existing distribution channels or inability to access new distribution channels;*

- *A reduction in assets under our management on short notice, through increased redemptions in our distribution channels or our Funds, particularly those Funds with a high concentration of assets, or investors terminating their relationship with us or shifting their funds to other types of accounts with different rate structures;*

- *A decrease in, or the elimination of, any future quarterly dividend paid to stockholders; and*

- *Our inability to hire and retain senior executive management and other key personnel.*

The foregoing factors should not be construed as exhaustive and should be read together with other cautionary statements included in this and other reports and filings we make with the Securities and Exchange Commission, including the information in Item 1 Business and Item 1A Risk Factors of Part I and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of Part II to our Annual Report on Form 10-K for the year ended December 31, 2009 and as updated in our quarterly reports on Form 10-Q during the year ending December 31, 2010. All forward-looking statements speak only as the date on which they are made and we undertake no duty to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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Overview

We are one of the oldest mutual fund and asset management firms in the country, with expertise in a broad range of investment styles and across a variety of market environments. Our earnings and cash flows are heavily dependent on financial market conditions. Significant increases or decreases in the various securities markets, particularly equity markets, can have a material impact on our results of operations, financial condition and cash flows.

We derive our revenues primarily from providing investment management, investment product underwriting and distribution, and shareholder services administration to mutual funds and institutional and separately managed accounts. Investment management fees are based on the amount of average assets under management and are affected by sales levels, financial market conditions, redemptions and the composition of assets. Our underwriting and distribution revenues consist of commissions derived from sales of investment and insurance products, distribution fees on certain variable products, and fees earned on fee-based asset allocation products, as well as advisory services. The products sold have various commission structures and the revenues received from product sales vary based on the type and amount sold. Rule 12b-1 service and distribution fees earned for servicing and/or distributing certain mutual fund shares are based upon assets under management and fluctuate based on sales, redemptions and financial market conditions. Other service fees include transfer agency fees, custodian fees for retirement plan accounts and portfolio accounting.

One of our distinctive qualities is that we are a significant distributor of investment products. Our retail products are distributed through our sales force of registered financial advisors (the Advisors channel) or through third-parties such as other broker/dealers, registered investment advisors (including the retirement advisors of Legend) and various retirement platforms, (collectively, the Wholesale channel). We also market our investment advisory services to institutional investors, either directly or through consultants (the Institutional channel).

Third Quarter Highlights

Our average assets under management during the third quarter of 2010 were 20% higher than our average assets under management during the third quarter of 2009, resulting in a significant increase in revenues for the current year. Ending assets under management of \$76.0 billion as of September 30, 2010 are 2% higher than our previous quarter-end high of \$74.2 billion at March 31, 2010.

Our balance sheet remains strong, and we ended the quarter with cash and investments of over \$342.0 million. We renewed our \$125.0 million credit facility during the third quarter and have successfully secured funding for senior notes with a delayed funding provision that will allow us to draw down the proceeds in January 2011 when the existing senior notes mature.

Potential Impact of Health Care Reform Legislation

In March of 2010, President Obama signed into law comprehensive health care reform legislation under the Patient Protection and Affordable Care Act (HR 3590) and the Health Care Education and Affordability Reconciliation Act (HR 4872) (the Acts). The Acts contain provisions that could impact the Company's accounting for its postretirement medical plan in future periods. However, the extent of that impact, if any, cannot

be determined until regulations are promulgated under the Acts and additional interpretations of the Acts become available.

Table of Contents**Assets Under Management**

Assets under management increased to nearly \$76.0 billion on September 30, 2010 compared to \$68.3 billion on June 30, 2010 due to market appreciation of \$7.0 billion and net flows of \$658 million.

Change in Assets Under Management(1)

| | Advisors | Third Quarter 2010 | | Total |
|--------------------------------------|-----------|--------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| (in millions) | | | | |
| Beginning Assets | \$ 28,215 | 32,523 | 7,541 | \$ 68,279 |
| Sales (net of commissions) | 839 | 2,933 | 905 | 4,677 |
| Redemptions | (919) | (2,566) | (704) | (4,189) |
| Net Sales | (80) | 367 | 201 | 488 |
| Net Exchanges | (138) | 27 | 115 | 4 |
| Reinvested Dividends & Capital Gains | 81 | 59 | 26 | 166 |
| Net Flows | (137) | 453 | 342 | 658 |
| Market Appreciation | 2,705 | 3,504 | 821 | 7,030 |
| Ending Assets | \$ 30,783 | 36,480 | 8,704 | \$ 75,967 |

| | Advisors | Third Quarter 2009 | | Total |
|--------------------------------------|-----------|--------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| (in millions) | | | | |
| Beginning Assets | \$ 25,205 | 23,213 | 7,193 | \$ 55,611 |
| Disposition of Assets | | | (488) | (488) |
| Sales (net of commissions) | 804 | 4,064 | 277 | 5,145 |
| Redemptions | (719) | (1,524) | (608) | (2,851) |
| Net Sales | 85 | 2,540 | (331) | 2,294 |
| Net Exchanges | (25) | 24 | | (1) |
| Reinvested Dividends & Capital Gains | 78 | 29 | 30 | 137 |
| Net Flows | 138 | 2,593 | (301) | 2,430 |
| Market Appreciation | 3,008 | 3,169 | 759 | 6,936 |
| Ending Assets | \$ 28,351 | 28,975 | 7,163 | \$ 64,489 |

(1) Includes all activity of the Funds and institutional accounts, including money market funds.

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Assets under management grew to nearly \$76.0 billion on September 30, 2010 compared to \$69.8 billion on December 31, 2009 due to net sales of \$3.7 billion and market appreciation of \$2.0 billion. Net sales were primarily driven by the Wholesale channel during the nine month period.

| | Advisors | Year to Date 2010 | | Total |
|--------------------------------------|-----------|-------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| (in millions) | | | | |
| Beginning Assets | \$ 29,474 | 32,818 | 7,490 | \$ 69,782 |
| Sales (net of commissions) | 2,680 | 10,893 | 2,491 | 16,064 |
| Redemptions | (2,582) | (7,976) | (1,771) | (12,329) |
| Net Sales | 98 | 2,917 | 720 | 3,735 |
| Net Exchanges | (230) | 115 | 115 | |
| Reinvested Dividends & Capital Gains | 242 | 160 | 75 | 477 |
| Net Flows | 110 | 3,192 | 910 | 4,212 |
| Market Appreciation | 1,199 | 470 | 304 | 1,973 |
| Ending Assets | \$ 30,783 | 36,480 | 8,704 | \$ 75,967 |

| | Advisors | Year to Date 2009 | | Total |
|--------------------------------------|-----------|-------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| (in millions) | | | | |
| Beginning Assets | \$ 23,472 | 17,489 | 6,523 | \$ 47,484 |
| Disposition of Assets | | | (488) | (488) |
| Sales (net of commissions) | 2,282 | 10,557 | 1,198 | 14,037 |
| Redemptions | (2,266) | (4,240) | (1,397) | (7,903) |
| Net Sales | 16 | 6,317 | (199) | 6,134 |
| Net Exchanges | (78) | 49 | 26 | (3) |
| Reinvested Dividends & Capital Gains | 258 | 113 | 82 | 453 |
| Net Flows | 196 | 6,479 | (91) | 6,584 |
| Market Appreciation | 4,683 | 5,007 | 1,219 | 10,909 |
| Ending Assets | \$ 28,351 | 28,975 | 7,163 | \$ 64,489 |

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Average assets under management, which are generally more indicative of trends in revenue for providing investment management services than the quarter over quarter change in ending assets under management, are presented below.

Average Assets Under Management

| Asset Class: | Advisors | Third Quarter 2010 | | Total |
|--------------|-----------|--------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| | | (in millions) | | |
| Equity | \$ 21,479 | 31,631 | 7,359 | \$ 60,469 |
| Fixed Income | 6,823 | 2,546 | 743 | 10,112 |
| Money Market | 1,267 | 278 | | 1,545 |
| Total | \$ 29,569 | 34,455 | 8,102 | \$ 72,126 |

| Asset Class: | Advisors | Third Quarter 2009 | | Total |
|--------------|-----------|--------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| | | (in millions) | | |
| Equity | \$ 19,937 | 24,265 | 6,447 | \$ 50,649 |
| Fixed Income | 5,391 | 1,339 | 671 | 7,401 |
| Money Market | 1,513 | 297 | | 1,810 |
| Total | \$ 26,841 | 25,901 | 7,118 | \$ 59,860 |

| Asset Class: | Advisors | Year to Date 2010 | | Total |
|--------------|-----------|-------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| | | (in millions) | | |
| Equity | \$ 21,992 | 31,822 | 7,136 | \$ 60,950 |
| Fixed Income | 6,443 | 2,216 | 722 | 9,381 |
| Money Market | 1,272 | 283 | | 1,555 |
| Total | \$ 29,707 | 34,321 | 7,858 | \$ 71,886 |

| Asset Class: | Advisors | Year to Date 2009 | | Total |
|--------------|-----------|-------------------|---------------|-----------|
| | | Wholesale | Institutional | |
| | | (in millions) | | |
| Equity | \$ 17,960 | 20,390 | 6,130 | \$ 44,480 |
| Fixed Income | 5,021 | 989 | 635 | 6,645 |
| Money Market | 1,674 | 299 | | 1,973 |
| Total | \$ 24,655 | 21,678 | 6,765 | \$ 53,098 |

Table of Contents**Results of Operations Three and Nine Months Ended September 30, 2010 as Compared with Three and Nine Months Ended September 30, 2009***Net Income*

| | Three months ended September 30, | | | Nine months ended September 30, | | |
|---------------------|--|--------|----------|------------------------------------|--------|----------|
| | 2010 | 2009 | Variance | 2010 | 2009 | Variance |
| | (in thousands, except per share amounts and percentage data) | | | | | |
| Net Income | \$ 40,533 | 33,413 | 21% | \$ 110,594 | 72,253 | 53% |
| Earnings per share: | | | | | | |
| Basic | \$ 0.47 | 0.39 | 21% | \$ 1.29 | 0.85 | 52% |
| Diluted | \$ 0.47 | 0.39 | 21% | \$ 1.29 | 0.84 | 54% |
| Operating Margin | 23.5% | 22.4% | 5% | 23.7% | 19.8% | 20% |

We reported net income of \$40.5 million, or \$0.47 per diluted share, for the third quarter of 2010 compared to \$33.4 million, or \$0.39 per diluted share, for the third quarter of 2009. Net income for the nine months ended September 30, 2010 was \$110.6 million, or \$1.29 per diluted share, compared to net income of \$72.3 million, or \$0.84 per diluted share, for the same period in 2009.

Total Revenues

Total revenues increased 17% to \$254.8 million for the three months ended September 30, 2010 compared to the three months ended September 30, 2009 due to a rise in average assets under management of 20%, partially offset by a decrease in gross sales of 9%. Revenues were \$763.6 million for the nine months ended September 30, 2010, an increase of 28% over revenues for the same period in 2009, attributable to a rise in average assets under management of 35% and an increase in gross sales of 14% for the nine months ended September 30, 2010 compared to the same period in the prior year.

| | Three months ended September 30, | | |
|------------------------------------|--|---------|----------|
| | 2010 | 2009 | Variance |
| | (in thousands, except percentage data) | | |
| Investment management fees | \$ 111,159 | 94,687 | 17% |
| Underwriting and distribution fees | 114,071 | 96,559 | 18% |
| Shareholder service fees | 29,577 | 26,730 | 11% |
| Total revenues | \$ 254,807 | 217,976 | 17% |

| | Nine months ended September 30, | | |
|--|--|------|----------|
| | 2010 | 2009 | Variance |
| | (in thousands, except percentage data) | | |

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| | | | | |
|------------------------------------|----|---------|---------|-----|
| Investment management fees | \$ | 333,874 | 248,234 | 34% |
| Underwriting and distribution fees | | 341,752 | 268,379 | 27% |
| Shareholder service fees | | 88,014 | 77,663 | 13% |
| Total revenues | \$ | 763,640 | 594,276 | 28% |

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Investment Management Fee Revenues

Investment management fee revenues are earned for providing investment advisory services to the Funds and to institutional and separate accounts. Investment management fee revenues increased \$16.5 million, or 17%, from last year's third quarter and \$85.6 million, or 34%, for the nine month period ended September 30, 2010 compared to the same period in 2009.

Revenues from investment management services provided to our retail mutual funds, which are distributed through the Advisors, Wholesale and Institutional channels, were \$102.8 million for the quarter ended September 30, 2010. Revenues increased \$15.3 million, or 18%, compared to the third quarter of 2009, while the related retail average assets increased 21% to \$64.0 billion. For the nine months ended September 30, 2010, revenues from investment management services provided to our retail mutual funds increased \$82.5 million, or 36%, to \$310.0 million compared to the first nine months of 2009, while the related retail average assets increased 38% to \$64.0 billion. For both comparative periods, investment management fee revenues increased less than the related retail average assets due to significant sales growth in our Asset Strategy funds and fixed income funds, which have lower than average management fee rates.

During the third quarter of 2009, we sold Austin, Calvert & Flavin, Inc. (ACF), a subsidiary that had assets under management of \$488 million as of the sale date. ACF's assets under management and related revenues were previously included in the Institutional channel's results.

Institutional account revenues were \$8.4 million for the third quarter of 2010, representing an increase of \$1.2 million, or 16%, from last year's third quarter, due to an increase in average assets of 14% and an increase in the average management fee rate. Year-to-date institutional account revenues increased 15% to \$23.9 million in 2010 compared to the same period in 2009, also due to an increase in average assets of 16% partially offset by a decline in the average management fee rate.

The long-term redemption rate (excluding money market fund redemptions) in the Advisors channel was 10.0% in this year's third quarter and 9.2% year-to-date, compared to 7.6% in the third quarter of 2009 and 8.7% for the first nine months of 2009. In the Wholesale channel, the long-term redemption rate was also higher in this year's third quarter, at 29.2%, compared to 22.5% in the third quarter of 2009. For the nine months ended September 30, 2010, the Wholesale channel's long-term redemption rate increased to 30.6% compared to 25.3% for the same period in 2009. Increased redemptions in our Asset Strategy and Global Natural Resources funds drove the increased redemption rates for both periods. We expect the Advisors channel long-term redemption rate to remain lower than that of the Wholesale channel due to the personal and customized nature in which our financial advisors provide service to our clients. Elevated rates in 2010 are a direct consequence of the volatility in the financial markets; however, our overall redemption rate remains low compared to the industry average.

The long-term redemption rate for our Institutional channel was 34.4% for the third quarter of both 2010 and 2009. For the nine month period ended September 30, 2010, the rate was 30.1% compared to 28.4% for the same period in 2009. Subadvisory and defined contribution business comprised nearly 60% of the Institutional channel's assets as of September 30, 2010 and unlike defined benefit pension accounts, the active daily flows in or out of these accounts causes the channel's redemption rate to be higher than it otherwise would be.

Table of Contents*Underwriting and Distribution Fee Revenues and Expenses*

The following tables summarize our underwriting and distribution fee revenues and expenses segregated by distribution method within the respective Advisors or Wholesale channel:

| | Third Quarter 2010 | | | | Total |
|---------------------------------|---------------------------|--------------------|-----------------------|---------------|--------------|
| | Advisors | Wholesale | | Legend | |
| | | Third-Party | (in thousands) | | |
| Revenue | \$ | 60,862 | 38,672 | 14,537 | \$ 114,071 |
| Expenses | | | | | |
| Direct | | 43,472 | 47,049 | 9,302 | 99,823 |
| Indirect | | 21,142 | 8,515 | 3,377 | 33,034 |
| | | 64,614 | 55,564 | 12,679 | 132,857 |
| Net Underwriting & Distribution | \$ | (3,752) | (16,892) | 1,858 | \$ (18,786) |

| | Third Quarter 2009 | | | | Total |
|---------------------------------|---------------------------|--------------------|-----------------------|---------------|--------------|
| | Advisors | Wholesale | | Legend | |
| | | Third-Party | (in thousands) | | |
| Revenue | \$ | 53,125 | 30,989 | 12,445 | \$ 96,559 |
| Expenses | | | | | |
| Direct | | 36,367 | 39,327 | 7,949 | 83,643 |
| Indirect | | 21,336 | 7,132 | 3,008 | 31,476 |
| | | 57,703 | 46,459 | 10,957 | 115,119 |
| Net Underwriting & Distribution | \$ | (4,578) | (15,470) | 1,488 | \$ (18,560) |

| | Year to Date 2010 | | | | Total |
|---------------------------------|--------------------------|--------------------|-----------------------|---------------|--------------|
| | Advisors | Wholesale | | Legend | |
| | | Third-Party | (in thousands) | | |
| Revenue | \$ | 182,843 | 115,531 | 43,378 | \$ 341,752 |
| Expenses | | | | | |
| Direct | | 129,163 | 143,529 | 27,598 | 300,290 |
| Indirect | | 65,734 | 24,641 | 9,564 | 99,939 |
| | | 194,897 | 168,170 | 37,162 | 400,229 |
| Net Underwriting & Distribution | \$ | (12,054) | (52,639) | 6,216 | \$ (58,477) |

| | Year to Date 2009 | | | | Total |
|----------|--------------------------|--------------------|-----------------------|---------------|--------------|
| | Advisors | Wholesale | | Legend | |
| | | Third-Party | (in thousands) | | |
| Revenue | \$ | 152,800 | 81,286 | 34,293 | \$ 268,379 |
| Expenses | | | | | |
| Direct | | 105,957 | 103,254 | 21,962 | 231,173 |

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| | | | | | | |
|---------------------------------|----|----------|----------|--------|----|----------|
| Indirect | | 63,993 | 20,728 | 8,724 | | 93,445 |
| | | 169,950 | 123,982 | 30,686 | | 324,618 |
| Net Underwriting & Distribution | \$ | (17,150) | (42,696) | 3,607 | \$ | (56,239) |

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Underwriting and distribution revenues earned in this year's third quarter increased \$17.5 million, or 18%, compared with the third quarter of 2009. A majority of the increase in revenues was due to higher Rule 12b-1 asset-based service and distribution fee revenues of \$10.3 million as a result of an increase in average mutual fund assets under management. Revenues from fee-based asset allocation products increased \$4.9 million compared to the prior year. Higher advisory fees and point of sale commissions earned by Legend increased revenue by \$1.3 million compared to the third quarter of 2009 while insurance-related revenues increased \$300 thousand.

Underwriting and distribution revenues earned for the nine months ended September 30, 2010 increased \$73.4 million, or 27%, compared with the same period in the prior year. The increase in revenues was due to higher Rule 12b-1 asset-based service and distribution fee revenues of \$47.5 million as a result of an increase in average mutual fund assets under management. Revenues from fee-based asset allocation products increased \$14.6 million compared to the prior year. Higher advisory fees and point of sale commissions earned by Legend increased revenue by \$6.4 million compared to the first nine months of 2009. Revenues on front-load product sales sold in the Advisors channel increased by \$4.7 million, which included an increase in Class A share revenues of \$1.2 million year over year. These increases were partially offset by a decrease in insurance-related revenues of \$2.0 million.

Underwriting and distribution expenses increased by \$17.7 million, or 15%, compared to the third quarter of 2009. A significant portion of this increase was attributed to higher direct expenses in the Wholesale channel of \$9.1 million as a result of an increase in average wholesale assets under management, partially offset by lower sales volume year over year. We also incurred higher dealer compensation paid to third party distributors, higher amortization expense of deferred sales commissions and increased Rule 12b-1 asset-based service and distribution expenses. Wholesaler commissions expense in the third quarter of 2010 decreased compared to the third quarter of 2009 due to lower sales volumes. Direct expenses in the Advisors channel increased \$7.1 million, or 20%, compared to the third quarter of 2009 due to increased commissions related to the sale of fee-based asset allocation products of \$3.3 million, higher Rule 12b-1 asset-based service and distribution commissions of \$2.6 million and higher commissions on insurance products of \$300 thousand. Indirect expenses increased \$1.6 million quarter over quarter. The indirect expense decrease of \$200 thousand in the Advisors channel relates to lower information technology expenses. The indirect expense increase of \$1.8 million in the Wholesale channel relates to increased employee compensation and benefits expenses, increased marketing costs and higher business meeting and travel expenses.

Underwriting and distribution expenses increased by \$75.6 million, or 23%, compared to the first nine months of 2009. Of this increase, \$45.9 million was related to higher direct expenses in the Wholesale channel as a result of an increase in average wholesale assets under management and slightly increased sales volume year over year. We also incurred higher dealer compensation paid to third party distributors, higher amortization expense of deferred sales commissions and increased Rule 12b-1 asset-based service and distribution expenses. Wholesaler commissions expense recorded in 2010 decreased compared to the nine months ended September 30, 2009 due to lower sales volumes upon which commissions expense is calculated period over period. For the nine months ended September 30, 2010, direct expenses in the Advisors channel increased \$23.2 million, or 22%, compared to the same period in 2009, due to increased commissions related to the sale of fee-based asset allocation products of \$12.5 million and higher Rule 12b-1 asset-based service and distribution commissions of \$9.5 million. These increases were partially offset by lower commissions on insurance products of \$1.3 million. Indirect expenses increased \$6.5 million compared to the first nine months of 2009. The indirect expense increase of \$1.7 million in the Advisors channel relates to increased employee compensation and benefits expenses and higher information technology expenses. The indirect expense increase of \$4.8 million in the Wholesale channel relates to increased employee compensation and benefits expenses, higher marketing costs and higher business meeting and travel expenses.

Table of Contents*Shareholder Service Fees Revenue*

Shareholder service fees revenue primarily includes transfer agency fees, custodian fees from retirement plan accounts, and portfolio accounting and administration fees. Portfolio accounting and administration fees are asset-based revenues or account-based revenues while transfer agency fees and custodian fees from retirement plan accounts are based on the number of accounts. During the third quarter of 2010, shareholder service fees revenue increased \$2.8 million, or 11%, over the third quarter of 2009. Of this increase, \$1.5 million is due to higher asset-based fees quarter over quarter in certain share classes and \$1.3 million is attributable to account-based revenues, due to a 7% increase in the average number of accounts. For the nine months ended September 30, 2010, shareholder service fees revenue increased \$10.4 million, or 13%, compared to the prior year. Of this increase, \$6.4 million is due to higher asset-based fees and \$4.0 million is related to account-based revenues, due to a 9% increase in the average number of accounts.

Total Operating Expenses

Operating expenses increased \$25.9 million, or 15%, in the third quarter of 2010 compared to the third quarter of 2009. For the nine months ended September 30, 2010, operating expenses increased \$106.4 million, or 22%, compared to the same period in 2009. For both periods, expenses increased primarily due to increased underwriting and distribution expenses and compensation and related costs. Underwriting and distribution expenses are discussed above.

| | Three Months Ended September 30, | | | Variance |
|--------------------------------|---|-------------|--|-----------------|
| | 2010 | 2009 | | |
| | (in thousands, except percentage data) | | | |
| Underwriting and distribution | \$ 132,857 | 115,119 | | 15% |
| Compensation and related costs | 36,164 | 29,275 | | 24% |
| General and administrative | 16,022 | 15,106 | | 6% |
| Subadvisory fees | 6,481 | 6,129 | | 6% |
| Depreciation | 3,526 | 3,503 | | 1% |
| Total operating expenses | \$ 195,050 | 169,132 | | 15% |

| | Nine Months Ended September 30, | | | Variance |
|--------------------------------|--|-------------|--|-----------------|
| | 2010 | 2009 | | |
| | (in thousands, except percentage data) | | | |
| Underwriting and distribution | \$ 400,229 | 324,618 | | 23% |
| Compensation and related costs | 103,444 | 82,373 | | 26% |
| General and administrative | 48,417 | 43,022 | | 13% |
| Subadvisory fees | 20,441 | 16,317 | | 25% |
| Depreciation | 10,457 | 10,259 | | 2% |
| Total operating expenses | \$ 582,988 | 476,589 | | 22% |

Compensation and Related Costs

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In the third quarter of 2010, compensation and related costs increased \$6.9 million compared to the third quarter of 2009, due to higher incentive compensation expense of \$1.8 million and higher base salaries and payroll taxes of \$1.6 million due to increased headcount and annual salary increases. These increases were offset by increased capitalized software development activities of \$400 thousand. Share-based compensation increased \$3.3 million compared to the third quarter of 2009 primarily due to higher amortization expense associated with our April 2010 and December 2009 grants of nonvested stock compared to grants that became fully vested in 2010 and higher non-employee advisor (independent contractor) stock award amortization expense in 2010. Non-employee stock awards are adjusted to market each period based on the fluctuation in our share price.

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Compensation and related costs for the nine months ended September 30, 2010 increased \$21.1 million compared to the same period in 2009, primarily due to higher incentive compensation expense of \$10.0 million compared to 2009. Base salaries and payroll taxes increased \$3.9 million due to increased headcount and annual salary increases. These expense increases were partially offset by increased capitalized software development activities of \$1.1 million and decreased group insurance costs of \$400 thousand due to favorable claims activity. Share-based compensation increased \$7.5 million compared to the first nine months of 2009 primarily due to higher amortization expense associated with our April 2010, December 2009 and April 2009 grants of nonvested stock compared to grants that became fully vested in 2010, partially offset by lower non-employee advisor (independent contractor) stock award amortization expense in 2010.

General and Administrative Costs

General and administrative expenses increased \$900 thousand to \$16.0 million for the third quarter of 2010 compared to the third quarter of 2009 due to higher dealer services costs of \$1.1 million and increased legal expenses compared to the prior year, partially offset by lower fund expenses of \$1.5 million. The third quarter of 2009 included a charge of \$543 thousand for severance and other transaction costs related to the divestiture of our subsidiary, ACF.

General and administrative expenses of \$48.4 million for the first nine months of 2010 represents an increase of \$5.4 million, or 13%, compared to the first nine months of 2009. Of this increase, \$1.3 million is due to a trade order execution error that occurred during the first quarter of 2010. Additional risk management procedures have been implemented, which we believe should substantially reduce the risk of similar errors occurring in the future. The increase is also due to higher dealer services costs of \$3.5 million, higher legal fees compared to the prior year and higher computer services and software costs of \$900 thousand. These increases were partially offset by lower fund expenses of \$1.5 million. The nine month period ended September 30, 2009 included charges of \$1.1 million for severance and other transaction costs related to the divestiture of ACF.

Subadvisory Fees

Subadvisory fees represent fees paid to other asset managers for providing advisory services for certain mutual fund portfolios. These expenses reduce our operating margin since we pay out approximately half of our management fee revenue received from subadvised products. Gross management fee revenues for products subadvised by others were \$12.9 million for the three months ended September 30, 2010 compared to \$12.1 million for the third quarter of 2009 due to an 8% increase in average net assets. For the nine months ended September 30, 2010, gross management fee revenues for products subadvised by others were \$40.6 million compared to \$32.4 million for the same period in 2009 due to a 28% increase in average net assets. Subadvisory expenses followed the same pattern of increase compared to 2009.

Subadvised average assets under management were \$6.3 billion and \$6.7 billion for the quarter and nine months ended September 30, 2010, respectively, compared to the annual average of \$5.6 billion for 2009. Since subadvisory expenses are a function of sales, redemptions and market action for subadvised assets, the higher asset base will likely result in an increase to both gross management fee revenues and subadvisory expenses for the remainder of 2010.

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Other Income and Expenses

Investment and Other Income (Loss), Interest Expense and Taxes

Investment and other income totaled \$3.9 million for the quarter ended September 30, 2010, compared to \$2.3 million in the same period a year ago. The main driver of this change was the increased gains recorded in our mutual fund trading portfolio in 2010 of \$3.0 million compared to 2009. We also recorded gains of \$300 thousand from the sale of available-for-sale mutual fund holdings in the third quarter of 2010. Partially offsetting these gains was a write-down of the Company's investment in a limited partnership during the current year's third quarter. Investment and other income for the nine months ended September 30, 2010 and 2009 was \$3.2 million and \$1.4 million, respectively. The current year includes gains recorded in our mutual fund trading portfolio of \$2.8 million compared to gains in 2009 of \$3.6 million. We also recorded gains of \$1.1 million from the sale of available-for-sale mutual fund holdings in the nine month period ended September 30, 2010. Partially offsetting these gains was a write-down of the Company's investment in a limited partnership during the current year. In 2009, we recorded a \$3.7 million non-cash charge to reflect the other than temporary impairment of certain of the Company's investments in affiliated mutual funds as their fair value was below cost for an extended period.

Interest expense was \$3.1 million and \$3.2 million for the third quarter of 2010 and 2009, respectively. For the nine months ended September 30, 2010 and 2009, interest expense was \$9.8 million and \$9.5 million, respectively. The increase from 2009 is due to costs associated with the repurchase of \$10.0 million of debt in the first quarter of 2010 as well as higher costs in 2010 for our \$125.0 million revolving credit facility.

Our effective tax rate was 33.1% for the third quarter of 2010, as compared to 30.4% in the third quarter of 2009. The lower effective tax rate in 2009 was largely attributable to the carryback of capital losses generated in connection with the sale of ACF, which offset the taxes paid on capital gains in previous years. In the third quarter of 2009, the Company also established a valuation allowance against the deferred tax assets that are capital in nature whereby future realization is not more likely than not. An increase in the fair value of our investment portfolios in the third quarter of 2010 allowed for the release of \$3.2 million of the valuation allowance against deferred tax assets that are capital in nature. Of this decrease to the valuation allowance, \$2.1 million was recorded to tax expense and, as a result, decreased our effective tax rate. The third quarter 2010 and 2009 effective tax rates, removing the effects of the sale of ACF and the valuation allowance, would have been 37.8% and 35.6%, respectively. The increase in the adjusted effective tax rate is due to fewer state tax incentives related to capital expenditures made by the Company in the third quarter of 2010 as compared to the third quarter of 2009 and changes in state legislation in jurisdictions in which the Company operates.

Our effective tax rate was 36.5% for the nine months ended September 30, 2010, as compared to 34.1% for the nine months ended September 30, 2009. Excluding the \$1.2 million decrease to the valuation allowance recorded for the nine months ended September 30, 2010, the effective tax rate would have been 37.5%. Excluding the aforementioned sale of ACF and valuation allowance, the effective tax rate for the nine months ended September 30, 2009 would have been 36.4%. The adjusted effective tax rate increased due to fewer state tax incentives related to capital expenditures made by the Company during the nine months ended September 30, 2010 as compared to the relative period in 2009, and changes in state legislation in jurisdictions in which the Company operates.

The Company expects its future effective tax rate, exclusive of any increases or reductions to the valuation allowance, state tax incentives, unanticipated state tax legislative changes, and unanticipated decreases in earnings to range from 36.8% to 37.8%.

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Liquidity and Capital Resources

Our operations provide much of the cash necessary to fund our priorities, as follows:

- Finance internal growth
- Pay dividends
- Repurchase our stock

Finance Internal Growth

We use cash to fund growth in our distribution channels. Our Wholesale channel, which has a higher cost to gather assets, requires cash outlays for wholesaler commissions and commissions to third parties on deferred load product sales. We continue to invest in our Advisors channel by providing additional support to our advisors through training opportunities, wholesaling efforts and enhanced technology tools, including compliance-related technology.

Dividends

We paid quarterly dividends on our common stock that resulted in financing cash outflows of \$49.0 million for the first nine months of 2010. The dividends paid on our common stock during the first nine months of 2009 resulted in financing cash outflows of \$48.8 million.

Repurchases

We repurchased 1,916,297 shares and 1,772,843 shares of our common stock in the open market or privately during the nine months ended September 30, 2010 and 2009, respectively, resulting in cash outflows of \$61.4 million and \$40.4 million, respectively.

Operating Cash Flows

Cash from operations is our primary source of funds and increased \$41.4 million for the nine months ended September 30, 2010 compared to the previous year. The increase is due to higher net income, higher non-cash share-based compensation expense and higher non-cash amortization of deferred sales commissions, partially offset by increased purchases of trading securities and an increase in deferred sales commission payments related to sales of deferred load and fee based products. The payable to investment companies for securities account can fluctuate significantly based on trading activity at the end of a reporting period, and from December 31, 2009 to September 30, 2010 there was a significant decrease in Fund shareholder investments received prior to the balance sheet date that were in the process of being invested in the Funds. On December 31, 2009, the Company changed the trustee of its 401(k) plan. Approximately \$100 million of the payable to investment companies for securities balance was due to the transfer of assets between trustees. As a result, on our consolidated balance sheet there was a decrease in both the payable to investment companies and a decrease in the cash and receivable accounts from December 31, 2009 to September 30, 2010. On the statement of cash flows, there were corresponding increases and decreases to cash from operations. There is no impact to the Company's liquidity and operations for the variations in these accounts.

During the nine months ended September 30, 2010, we made a \$10.0 million contribution to the Pension Plan. In October 2010, we made an additional \$2.5 million contribution to the Pension Plan. We do not expect to make additional contributions to the Pension Plan for the remainder of 2010.

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Investing Cash Flows

Investing cash flows consist primarily of the purchase of, and proceeds from, the sales and maturities of available-for-sale investment securities, as well as capital expenditures. We expect our 2010 capital expenditures to be in the range of \$15.0 to \$20.0 million.

Financing Cash Flows

As noted previously, dividends and stock repurchases accounted for a majority of our financing cash outflows in the first nine months of 2010 and 2009.

Additionally, during 2010 we repurchased \$10.0 million of our \$200.0 million aggregate principal amount 5.6% senior notes due January 2011 (the Notes). In the first quarter of 2010, we reclassified the Notes from long-term debt to short-term debt due to their scheduled maturity within the next 12 months. On August 31, 2010, the Company entered into an agreement to complete a \$190.0 million private placement of Senior Notes (the Senior Notes). The proceeds of this debt issuance will be used to refinance the existing \$190.0 million in senior notes expiring in January 2011. The Notes will be unsecured and will be issued in two tranches: \$95.0 million bearing interest at 5% and maturing January 13, 2018 and \$95.0 million bearing interest of 5.75% and maturing January 13, 2021. Interest will be payable semi-annually in January and July of each year. The Senior Notes contain a delayed funding provision that will allow the Company to draw down the proceeds in January 2011 when the existing senior notes mature.

Simultaneous with the refinancing of our senior notes, the Company entered into a three year revolving credit facility (the Credit Facility) with various lenders, effective August 31, 2010, which initially provides for borrowings of up to \$125.0 million and replaced the Company's previous revolving credit facility. Lenders could, at their option upon the Company's request, expand the facility to \$200.0 million. At September 30, 2010, there were no borrowings outstanding under the Credit Facility.

Future Capital Requirements

Management believes its available cash, marketable securities and expected cash flow from operations will be sufficient to fund its short-term operating and capital requirements. Expected short-term uses of cash include dividend payments, interest payments on outstanding debt, income tax payments, seed money for new products, share repurchases, payment of deferred commissions to our financial advisors and third parties, capital expenditures, pension funding, home office leasehold improvements, and could include strategic acquisitions.

Expected long-term capital requirements include indebtedness, payment of upfront fund commissions for Class B shares, Class C shares and certain fee-based asset allocation products, operating leases and purchase obligations, and income tax payments. Other possible long-term discretionary uses of cash could include capital expenditures for enhancement of technology infrastructure and home office expansion, strategic acquisitions, payment of dividends, seed money for new products and repurchases of our common stock.

Critical Accounting Policies and Estimates

Management believes certain critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. The Company's critical accounting policies and estimates are disclosed in the Critical Accounting Policies and Estimates section of our 2009 Form 10-K. The Company modified its accounting policy disclosure related to goodwill and identifiable intangible assets, which is summarized in its Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010.

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Supplemental Information

| | Third Quarter 2010 | Third Quarter 2009 | Change | Year to Date 2010 | Year to Date 2009 | Change |
|--|--------------------------|--------------------------|--------|-------------------------|-------------------------|--------|
| <u>Redemption rates - long term (annualized)</u> | | | | | | |
| Advisors | 10.0% | 7.6% | | 9.2% | 8.7% | |
| Wholesale | 29.2% | 22.5% | | 30.6% | 25.3% | |
| Institutional | 34.4% | 34.4% | | 30.1% | 28.4% | |
| Total | 22.1% | 17.4% | | 21.9% | 18.1% | |
| GDC per advisor (000 s) | 29.1 | 22.8 | 27.6% | 84.7 | 66.9 | 26.6% |
| Average number of financial advisors (1) | 1,978 | 2,376 | -16.8% | 2,058 | 2,323 | -11.4% |
| Number of financial advisors (1) | 1,950 | 2,404 | -18.9% | | | |
| Number of shareholder accounts (000 s) | 4,015 | 3,805 | 5.5% | | | |
| Number of shareholders | 911,910 | 874,506 | 4.3% | | | |

(1) Excludes Legend advisors

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company has had no significant changes in its Quantitative and Qualitative Disclosures About Market Risk from that previously reported in the Company's 2009 Form 10-K.

Item 4. Controls and Procedures

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be timely disclosed, is accumulated and communicated to management in a timely fashion. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report, have concluded that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

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The Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There were no changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. However, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Table of Contents**Part II. Other Information****Item 1. Legal Proceedings**

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 the 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. Information required to be reported under this Part II., Item 1. has been previously disclosed in Note 10 to the consolidated financial statements in Part I. above and is incorporated herein by reference.

Item 1A. Risk Factors

The Company has had no material changes to its Risk Factors from those previously reported in the Company's 2009 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth certain information about the shares of common stock we repurchased during the third quarter of 2010.

| Period | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Program |
|----------------------------|--------------------------------------|------------------------------|--|--|
| July 1 - July 31 | 742 | \$ 24.31 | 742 | n/a(1) |
| August 1 - August 31 | 440 | 22.89 | 440 | n/a(1) |
| September 1 - September 30 | 35,905 | 27.36 | 35,905 | n/a(1) |
| Total | 37,087 | \$ 27.25 | 37,087 | |

(1) On August 31, 1998, we announced that our Board of Directors approved a program to repurchase shares of our common stock on the open market. Under the repurchase program, we are authorized to repurchase, in any seven-day period, the greater of (i) 3% of our outstanding common stock or (ii) \$50 million of our common stock. We may repurchase our common stock through the New York Stock Exchange, other national or regional market systems, electronic communication networks or alternative trading systems such as POSIT, during regular or after-hours trading sessions. POSIT is an alternative trading system that uses passive pricing to anonymously match buy and sell orders. To date, we have not used electronic communication networks or alternative trading systems to repurchase any of our common stock and do not intend to use such networks or systems in the foreseeable future. Our stock repurchase program does not have an expiration date or an aggregate maximum number or dollar value of shares that may be repurchased. Our Board of Directors reviewed and ratified the stock repurchase

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program in July 2004. During the third quarter of 2010, all stock repurchases were made pursuant to the repurchase program including 27,087 shares, reflected in the table above, that were purchased in connection with funding employee income tax withholding obligations arising from the vesting of nonvested shares.

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Item 6. Exhibits

- 10.1 Credit Agreement, dated August 31, 2010, by and among Waddell & Reed Financial, Inc., the lenders party thereto, Bank of America, N.A., as Administrative Agent, Bank of America Securities LLC., as Lead Arranger and Book Manager, UMB Bank, N.A. and The Bank of Nova Scotia as Co-Syndication Agents, and Citibank, N.A. and Wells Fargo Bank, N.A. as Co-Documentation Agents. Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K, File No. 333-43687, on September 7, 2010 and incorporated herein by reference.
- 10.2 Note Purchase Agreement, dated August 31, 2010, by and among Waddell & Reed Financial, Inc. and the purchasers party thereto. Filed as Exhibit 10.2 to the Company's Current Report on Form 8-K, File No. 333-43687, on September 7, 2010 and incorporated herein by reference.
- 31.1 Section 302 Certification of Chief Executive Officer
- 31.2 Section 302 Certification of Chief Financial Officer
- 32.1 Section 906 Certification of Chief Executive Officer
- 32.2 Section 906 Certification of Chief Financial Officer
- 101 Materials from the Waddell & Reed Financial, Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2010, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statement of Stockholders' Equity, (iv) Consolidated Statements of Comprehensive Income, (v) Consolidated Statements of Cash Flows, and (vi) related Notes to the Unaudited Consolidated Financial Statements, tagged as blocks of text.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 28th day of October 2010.

WADDELL & REED FINANCIAL, INC.

By: */s/ Henry J. Herrmann*
Chief Executive Officer, Chairman of the Board and
Director
(Principal Executive Officer)

By: */s/ Daniel P. Connealy*
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

By: */s/ Brent K. Bloss*
Senior Vice President - Finance and Treasurer
(Principal Accounting Officer)