

## Option Level Descriptions for Accounts at Baird

The option level that an investor is approved for is generally determined by, among other things, the amount of risk involved in the strategies to be followed. The chart below describes Baird's option approval levels. The most conservative option strategies correspond with the lowest numerical level of option approval, i.e. Level 1 being the lowest risk option transactions and Level 6 being the highest risk. Thus, any option account approved for any level higher than Level 1 is also approved for any lesser level.

Trading Level	Objective	Risk
<b>Level 1: Covered Call Writing</b>	<b>Preserving capital and/or generation of income.</b> Investors write (sell) covered calls primarily for two reasons – seeking to realize additional returns on their underlying stock by earning premium income; and to gain some protection (limited to the amount of the premium) from a decline in the stock price. The covered call writer is looking for a steady or slightly rising stock price for at least the term of the option. This strategy may not be appropriate for a very bearish or a very bullish investor.	<b>Limited upside potential and risk of losing the stock.</b> The writer of a covered call option, in return for the premium he receives, forgoes the opportunity to benefit from an increase in the stock price which exceeds the strike price of his option, but continues to bear the risk of a sharp decline in the value of his stock which will only be slightly offset by the premium he received for selling the option. You should be prepared to deliver the necessary shares of the underlying stock (if assigned) at any time during the life of the option. Provided that your position has not been assigned, you may cancel your obligation by executing a closing transaction, meaning buying the call back at the current market price of the call.
<b>Level 2: Cash Secured Put Writing</b>	<b>Preserving capital and/or generation of income.</b> Investors write (sell) cash secured puts primarily to be assigned and acquire the stock below today's price, or for earning premium income. A put writer (seller) must deposit cash or cash equivalents equal to the exercise value of the option. The purpose of having the money in the account is to assure the funds are available to purchase the stock should the put be assigned. The writer receives a premium for selling the put. This is primarily a stock acquisition strategy for a price-sensitive investor. The investor is bullish on the underlying, but looking for a short-term dip in the stock price, followed by longer-term appreciation.	<b>Assuming the obligation to buy a particular stock at a higher price (strike price) than the current stock price.</b> The writer of a cash secured put receives the premium for selling the put, but will be obligated to buy the stock at the strike price during the life of the option should the put be assigned. The writer must be comfortable with the strike price as an acceptable long-term acquisition price (minus the option premium received) no matter how low the stock price goes. Provided that your position has not been assigned, you may cancel your obligation by executing a closing transaction, meaning buying the put back at the current market price of the put.

## Option Level Descriptions for Accounts at Baird, *continued.*

<p><b>Level 3: Purchasing Option Contracts</b></p>	<p><b>Speculation and growth – leveraging with a limited dollar risk.</b></p> <ul style="list-style-type: none"> <li>• <b>Buying calls</b> allows the investor to lock in a stock purchase price. An investor who sees an attractive stock price but does not have sufficient cash flow to buy at the present time can buy calls (giving him the right to buy) to lock in the purchase indicated by the strike price of the option for the life of the option.</li> <li>• <b>Buying calls</b> allows an investor to profit in the underlying stock's expected appreciation without the risk and up-front capital outlay of outright stock ownership (i.e. greater leverage). This strategy is for the bullish investor</li> <li>• <b>Buying Protective puts</b> allows the investor to lock in a price to sell the underlying stock at the option strike price. This strategy is a hedge against a dip in the stock's value.</li> <li>• <b>Buying Puts allows</b> an investor the opportunity to profit from a decrease in the stock price without risking an unlimited amount of capital as a short stock seller does (i.e. greater leverage). This strategy is for the bearish investor.</li> </ul>	<p><b>Potential for loss of entire investment - Loss is limited to the premium paid for the option.</b></p>
<p><b>Level 4: Spread Transactions</b></p>	<p><b>Speculation and/or appreciation. Spreads involve being both the buyer and the writer of the same type of option (puts or calls) on the same underlying stock, with the options having different strike prices and /or expiration dates.</b> The two main classes of spreads are the horizontal spread and the vertical spread. Vertical Spreads (a.k.a price spreads) having the same expiration date but different strike prices. Horizontal Spreads (a.k.a calendar spreads) having the same strike prices but different expiration dates. The primary objective is to reduce the risk associated with a simple long or short option position.</p>	<p><b>Level of risk depends on type of spread strategy implemented.</b> Option spreads are more complex than buying or writing a single option. An investor considering these complex strategies should recognize several risk-related consequences. Some of those being that it may at times be impossible to simultaneously execute transactions in all of the options involved in the combination; the possibility that a loss could be incurred on both sides of a transaction, and the increased risk exposure that would result from the exercise/assignment or closing out of one side of the trade while the other side of the trade remains outstanding. Spread (multi-leg) transactions may involve, if applicable, multiple commission charges.</p>
<p><b>Level 6: Uncovered Call and Put Writing (Naked Index Options are Prohibited)</b></p>	<p><b>Speculation and/or appreciation.</b></p> <ul style="list-style-type: none"> <li>• <b>Uncovered call writing</b> - An investor writes (sells) a call without owning the underlying stock. The writer receives the call option premium for selling the call but is obligated to sell stock and deliver the shares at the strike price if the call is assigned. As an uncovered call writer, the objective for writing an uncovered call is to earn premium income without committing capital to the ownership of the underlying stock. An uncovered call writer must maintain sufficient margin in case of assignment.</li> </ul>	<p><b>Uncovered option writing is suitable only for the knowledgeable investor who understands the risk involved and the potential for significant losses.</b> The potential loss of uncovered call writing is unlimited – if the market price of the stock rises sharply, the calls could be assigned and you would be required to buy the stock at the current market price and deliver the shares at the option's strike price, which could result in substantial loss. Uncovered put writing is also inherently risky as there is limited profit potential with potential for large losses if the market price of the stock falls sharply, the puts could be assigned and you would be required to buy the stock at the strike price, above the current market price. The loss is limited only by the fact that the stock's value cannot fall below zero.</p>

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- **Uncovered put writing** – An investor writes (sells) a put without having a short position in the stock. The writer receives the put option premium for writing the put but is obligated to buy the stock at the strike price if the put is assigned. As an uncovered put writer, the objective for writing an uncovered put is to earn premium income. An uncovered put writer is also required to maintain sufficient margin in case of assignment.

### For all Option Strategies (if applicable)

#### Automatic Exercise Long Options

It is extremely important to realize that any expiring long equity or index options in-the-money by \$0.01 or more will automatically be exercised by the OCC unless Baird receives specific instructions not to exercise before 4:30 p.m. (EST). This would require buying the underlying stock at the strike price for holders of long calls or selling the underlying stock at the strike price for holders of long puts. Index option exercise settlement is for cash.

#### Taxes

Because of the importance of tax considerations to all option trading, it cannot be emphasized enough that the client who is considering options, should consult with their tax advisor as to how taxes may affect the outcome of contemplated option transactions.

If you have questions or need more information, please contact your Baird Financial Advisor.

For additional information, please contact your Baird Financial Advisor or visit the [Options Clearing Corporation](#) website for a copy of the disclosure document titled [Characteristics and Risks of Standardized Options](#). Options are not suitable for all investors. All risks must be considered carefully before implementing any strategies.