

Option Basics IV Rank

Using IV Rank as an Indicator for
Options

IV Rank – What is it? And why care?

What it is: IV Rank is the current *relation of Implied Volatility* to the *historical range of Implied Volatility* of an asset/instrument. It ranges from 0 to 100 – with 100 being the highest.

Why we care: It directly affects the amount of premium we collect from selling options. It affects the amount that we pay buying options! Options that are higher in IV Rank are more expensive – meaning more seller premium, thereby bettering your overall risk reward ratio.

How we read this

IV Rank 50 or more – classified as High IV Ranking
Any IV Rank below 50 – low IV

*** Clearer indicator – IV Rank in options than just taking IV into account.

Historical IV

FYI: Usually your Historical IV data is already provided for you on your platform. Computation may vary depending on broker but in most cases default values used for computing this figure will be from the moving average of 30 day OTM Options.

Our Formula

$$\text{IV Rank} = \left(\frac{\text{(actual IV - lowest hist. IV)}}{\text{(highest hist. IV - lowest hist. IV)}} \right) \times 100$$

Examples

Let's say the last 4 historical IV data of a specific option chain are as follows: 20%, 30%, 50% und 80%.

1. What is the IV Rank if current IV is 30%?
2. What is the IV Rank if current IV is 50%?
3. What is the IV Rank if current IV is 80%?

IV is 30%

$$\text{IV Rank} = \left(\frac{(30\% - 20\%)}{(80\% - 20\%)} \right) \times 100 = 17$$

IV is 50%

$$\text{IV Rank} = \left(\frac{(50\% - 20\%)}{(80\% - 20\%)} \right) \times 100 = 50$$

IV is 80%

$$\text{IV Rank} = \left(\frac{(80\% - 20\%)}{(80\% - 20\%)} \right) \times 100 = 100$$

IV Rank relevant

It answers the question: is the IV higher than this stock/assets' normal IV activity? In terms of option pricing, this translates: „Is the option priced higher than it is usually priced“?

--- The IV Rank is key to answering which option strategy to use to take advantage of the pricing effect of options. ---

Conclusion

Since options are priced at a premium when IV rank is high:

- It makes sense to sell options or have a net short strategy when IV rank is high.
- A net long strategy works more to your favor when IV rank is relatively low.