

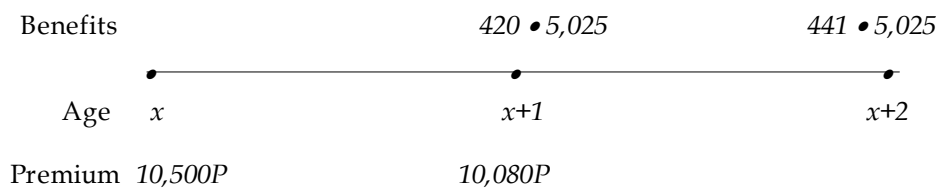
Actuarial models

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Solutions to practice questions – Chapter 4

Solution 4.1



Solution 4.2

$$10,500P + \frac{10,080P}{1.05} = \frac{420 \times 5,025}{1.05} + \frac{441 \times 5,025}{1.05^2} \Rightarrow P = \frac{4,020,000}{20,100} = 200$$

Solution 4.3

Year	Beginning fund	Premium	Interest	Benefits	Ending fund
1	0	2,100,000	105,000	2,110,500	94,500
2	94,500	2,016,000	105,525	2,216,025	0

Solution 4.4

If the premium is zero, then the ending fund is calculated as below:

Year	Beginning fund	Premium	Interest	Benefits	Ending fund
1	0	0	0	2,110,500	-2,110,500
2	-2,110,500	0	-105,525	2,216,025	-4,432,050

If the premium is 1, then the ending fund is determined as below:

Year	Beginning fund	Premium	Interest	Benefits	Ending fund
1	0	10,500	525	2,110,500	-2,099,475
2	-2,099,475	10,080	-104,469.75	2,216,025	-4,409,889.75

The linear function $EF(P)$ has slope m :

$$m = \frac{-4,409,889.75 + 4,432,050}{1-0} = 22,160.25$$

Using the slope-intercept form of a linear equation we have:

$$EF(P) = -4,432,050 + 22,160.25P \quad , \quad 0 = EF(P) \Rightarrow P = \frac{4,432,050}{22,160.25} = 200$$

Solution 4.5

$$\mu(x) = \mu = -\ln(0.98) \Rightarrow {}_k p_x = e^{-\mu k} = 0.98^k \quad , \quad q_{x+k} = 0.02$$

$$A_x = \sum_{k=0}^{\infty} v^{k+1} {}_k p_x q_{x+k} = \sum_{k=0}^{\infty} v^{k+1} 0.98^k \times 0.02 = \sum_{k=0}^{\infty} \frac{1}{1.05^{k+1}} \times 0.98^k \times 0.02$$

$$= \frac{0.02}{1.05} \left(1 + \left(\frac{0.98}{1.05}\right)^1 + \left(\frac{0.98}{1.05}\right)^2 + \dots \right) \quad (\text{geometric series})$$

$$= \frac{0.02}{1.05} \left(\frac{1}{1 - 0.98/1.05} \right) = \frac{0.02}{0.07} \Rightarrow$$

$$\ddot{a}_x = \frac{1 - A_x}{d} = \frac{5/7}{5/105} = 15$$

$$1,000 P_x = \frac{1,000 A_x}{\ddot{a}_x} = \frac{2,000/7}{15} = 19.04762$$

Solution 4.6

For the semi-continuous plan we have:

$$\bar{A}_x = \frac{\mu}{\mu + \delta} = \frac{-\ln(0.98)}{-\ln(0.98) + \ln(1.05)} = 0.29282 \quad , \quad \ddot{a}_x = 15 \quad (\text{Solution 4.5}) \Rightarrow$$

$$1,000 P(\bar{A}_x) = \frac{1,000 \bar{A}_x}{\ddot{a}_x} = \frac{292.82}{15} = 19.52154$$

Solution 4.7

The relation $\bar{A}_x = (i/\delta)A_x$ only holds when the UDD assumption holds. This assumption would require ${}_t p_x$ to be a linear function of t when x is an integer age and $0 < t < 1$. But with the constant force model we would have ${}_t p_x = 0.98^t$, which is not linear in t .

Let's see how close to an answer the UUD law would have given if you had mistakenly applied it:

$$(i/\delta)1,000 A_x = (0.05/\ln(1.05)) \times 19.04762 = 19.51994$$

This is pretty close to the true value obtained in Solution 4.6.

Solution 4.8

$$1,000 {}_{10}P(\bar{A}_{30:\overline{35}|}^1) = \frac{1,000 \bar{A}_{30:\overline{35}|}^1}{\ddot{a}_{30:\overline{10}|}}$$

Solution 4.9

$$P \ddot{a}_{55:\overline{10}|} = 50,000 {}_{10}|\ddot{a}_{55}$$

Solution 4.10

With de Moivre's law it is easy to calculate whole life insurance values from the formula $A_x = a_{\overline{\omega-x}|} / (\omega - x)$:

$$A_{55} = \frac{a_{\overline{35}|}}{35} = \frac{16.37419}{35} = 0.46783 \quad , \quad A_{65} = \frac{a_{\overline{25}|}}{25} = \frac{14.09394}{25} = 0.56376 \quad \Rightarrow$$

$$\ddot{a}_{55} = 11.17548 \quad , \quad \ddot{a}_{65} = 9.16109$$

The premium that we need to calculate is:

$$P = \frac{50,000 {}_{10}|\ddot{a}_{55}}{\ddot{a}_{55:\overline{10}|}} = \frac{50,000 v^{10} {}_{10}p_{55} \ddot{a}_{65}}{\ddot{a}_{55} - v^{10} {}_{10}p_{55} \ddot{a}_{65}}$$

$$= \frac{50,000 \times (25/35) \times 9.16109 / 1.05^{10}}{11.17548 - (25/35) 9.16109 / 1.05^{10}} = \frac{200,861.16}{7.15826} = 28,060$$

Solution 4.11

With the first 5 payments guaranteed, the annuity APV ${}_{10}|\ddot{a}_{55}$ is replaced by:

$${}_{10}|\ddot{a}_{\overline{5}|} + {}_{15}|\ddot{a}_{55}$$

So now we need to compute \ddot{a}_{70} as well:

$$A_{70} = \frac{a_{\overline{20}|}}{20} = 0.62311 \quad \Rightarrow \quad \ddot{a}_{70} = 7.91468$$

Finally, the new annual premium amount is:

$$P = \frac{50,000 \left(\ddot{a}_{\overline{15}|} - \ddot{a}_{\overline{10}|} + {}_{15}p_{55} \ddot{a}_{55} \right)}{\ddot{a}_{55:\overline{10}|}} = \frac{50,000 \left(\ddot{a}_{\overline{15}|} - \ddot{a}_{\overline{10}|} + v^{15} {}_{15}p_{55} \ddot{a}_{70} \right)}{\ddot{a}_{55} - v^{10} {}_{10}p_{55} \ddot{a}_{65}}$$

$$= \frac{50,000 \left(2.79082 + (20/35) \times 7.91468 / 1.05^{15} \right)}{7.15826} = \frac{248,315.13}{7.15826} = 34,689$$

Solution 4.12

$$(i) \quad 1,000 P^{(2)}(\bar{A}_{40}) = \frac{1,000 \bar{A}_{40}}{\ddot{a}_{40}^{(2)}} = \frac{1,000 A_{40}(i/\delta)}{\alpha(2)\ddot{a}_{40} - \beta(2)} = \frac{161.32(0.06/\ln(1.06))}{1.00021 \times 14.8166 - 0.25739} = 11.40701$$

$$(ii) \quad 1,000 {}_{10}P^{(2)}(\bar{A}_{40}) = \frac{1,000 \bar{A}_{40}}{\ddot{a}_{40:\overline{10}|}^{(2)}} = \frac{1,000 A_{40}(i/\delta)}{\alpha(2)\ddot{a}_{40:\overline{10}|} - \beta(2)(1 - v^{10} {}_{10}p_{40})}$$

$$= \frac{161.32(0.06/\ln(1.06))}{1.00021 \times (14.8166 - 0.53667 \times 13.2668) - 0.25739(1 - 0.53667)} = 21.9173$$

Solution 4.13

Apply the equivalence principle. Suppose that P is the level annual premium rate and assume UDD:

$$P \ddot{a}_{40} = 1,000 \bar{A}_{40} + 1,000 {}_{10}|\bar{A}_{40} \Rightarrow$$

$$P = \frac{1,000 \bar{A}_{40} + 1,000 {}_{10}|\bar{A}_{40}}{\ddot{a}_{40}} = \frac{i}{\delta} \times \frac{1,000 A_{40} + v^{10} {}_{10}p_{40} \times 1,000 A_{50}}{\ddot{a}_{40}}$$

$$= \frac{0.06}{\ln(1.06)} \times \frac{161.32 + 0.53667 \times 249.05}{14.8166} = 20.50005$$

Solution 4.14

$$P(\ddot{a}_{40} + {}_{10}|\ddot{a}_{40}) = 1,000 \bar{A}_{40} + 1,000 {}_{10}|\bar{A}_{40} \Rightarrow$$

$$P = \frac{1,000 \bar{A}_{40} + 1,000 {}_{10}|\bar{A}_{40}}{\ddot{a}_{40} + {}_{10}|\ddot{a}_{40}} = \frac{i}{\delta} \times \frac{1,000 A_{40} + v^{10} {}_{10}p_{40} \times 1,000 A_{50}}{\ddot{a}_{40} + v^{10} {}_{10}p_{40} \ddot{a}_{50}}$$

$$= \frac{0.06}{\ln(1.06)} \times \frac{161.32 + 0.53667 \times 249.05}{14.8166 + 0.53667 \times 13.2668} = 13.84638$$

Solution 4.15Let $K=K(40)$:

$$L = 1,000 \times \begin{cases} v^{K+1} & \text{if } K \leq 9 \\ v^{10} & \text{if } K \geq 10 \end{cases} - P \times \begin{cases} \ddot{a}_{\overline{K+1}|} & \text{if } K \leq 9 \\ \ddot{a}_{\overline{10}|} & \text{if } K \geq 10 \end{cases}$$

$$= \begin{cases} 1,000v^{K+1} - P\ddot{a}_{\overline{K+1}|} & \text{if } K \leq 9 \\ 1,000v^{10} - P\ddot{a}_{\overline{10}|} & \text{if } K \geq 10 \end{cases}$$

Solution 4.16

$$E[L] = 1,000 A_{40:\overline{10}|} - 80 \ddot{a}_{40:\overline{10}|}$$

$$= (1,000 A_{40} - v^{10} {}_{10}p_{40} 1,000 A_{50} + 1,000 v^{10} {}_{10}p_{40}) - 80(\ddot{a}_{40} - v^{10} {}_{10}p_{40} \ddot{a}_{50})$$

$$= 564.34 - 80 \times 7.69671 = -51.40$$

Solution 4.17For an insurance of 1, the variance of the loss function at issue (L_1) using the formula from Section 4.5 of the text:

$$\text{var}(L_1) = (1 - E[L_1])^2 \left(\frac{{}^2A_{40:\overline{10}|} - (A_{40:\overline{10}|})^2}{(1 - A_{40:\overline{10}|})^2} \right)$$

If the benefit were 1 and the premium were 80/1,000, then $E[L_1] = -51.39914/1,000 = -0.05140$. Obtain the variance on a unit basis using the formula above. Then multiply by $1,000^2$ to obtain variance if the benefit is 1,000.

$$A_{40:\overline{10}|} = 0.56434 \quad (\text{Solution 4.16})$$

$${}^2A_{40:\overline{10}|} = ({}^2A_{40} - v^{20} {}_{10}p_{40} {}^2A_{50}) + v^{20} {}_{10}p_{40}$$

$$= \left(0.04863 - \frac{0.53667}{1.06^{10}} \times 0.09476 \right) + \frac{0.53667}{1.06^{10}} = 0.31991$$

$$\text{var}(L_1) = (1 - E[L_1])^2 \frac{{}^2A_{40:\overline{10}|} - (A_{40:\overline{10}|})^2}{(1 - A_{40:\overline{10}|})^2} = 1.05140^2 \times \left(\frac{0.31991 - 0.56434^2}{(1 - 0.56434)^2} \right) = 0.00833$$

Multiply this variance by $1,000^2$: $\text{var}(L) = \text{var}(1,000L_1) = 1,000^2 \times 0.00833 = 8,330$

Note: Your answer may differ slightly, depending on the intermediate rounding you've applied

Solution 4.18

With de Moivre's law we have:

$$\bar{A}_{40} = \frac{\bar{a}_{\overline{60}|}}{60} = 0.27019, \quad \bar{a}_{40} = \frac{1 - \bar{A}_{40}}{\delta} = 12.16354, \quad \bar{P}(\bar{A}_{40}) = 0.02221$$

The insurer's loss function at issue is:

$$L = e^{-\delta T(40)} - \bar{P}(\bar{A}_{40}) \bar{a}_{\overline{T(40)|}} = \left(1 + \frac{\bar{P}(\bar{A}_{40})}{\delta} \right) e^{-\delta T(40)} - \frac{\bar{P}(\bar{A}_{40})}{\delta}$$

The loss is positive if the following relation holds:

$$T(40) < -\frac{1}{\delta} \ln \left(\frac{\bar{P}(\bar{A}_{40})}{\bar{P}(\bar{A}_{40}) + \delta} \right) = 21.81063$$

The probability of this event is:

$$\Pr(T(40) < 21.81063) = \int_0^{21.81063} f_{T(40)}(t) dt = \int_0^{21.81063} \frac{1}{60} dt = \frac{21.81063}{60} = 0.36351$$

Solution 4.19

The loss function is a decreasing function of $T(40)$, so it flips the percentiles. Since we are looking for the median value, we merely need to plug $T = t_{0.5}$ into the loss function formula.

The future lifetime is uniformly distributed on the interval $[0, 60]$. The median value is $t_{0.5} = 30$. So the median value of the loss function is:

$$L = \left(1 + \frac{\bar{P}(\bar{A}_{40})}{\delta} \right) e^{-\delta T(40)} - \frac{\bar{P}(\bar{A}_{40})}{\delta} = \left(1 + \frac{0.02221}{0.06} \right) e^{-0.06 \times 30} - \frac{0.02221}{0.06} = -0.14372$$

Solution 4.20

The annual premium amount is $P = 1 / \bar{s}_{\overline{t_{0.2}}|}$ where $t_{0.2}$ is the 20th percentile of future lifetime. (See Example 4.13):

$$0.2 = \Pr(T(x) \leq t_{0.2}) \Rightarrow 0.8 = {}_{t_{0.2}}p_x = e^{-\mu t_{0.2}} \Rightarrow t_{0.2} = -\ln(0.8) / \mu$$

$$\bar{s}_{\overline{t_{0.2}}|} = \frac{e^{\delta t_{0.2}} - 1}{\delta} = \frac{e^{-\ln(0.8)\delta / \mu} - 1}{\delta} = \frac{1.25^{\delta / \mu} - 1}{\delta}$$

$$P = \frac{1}{\bar{s}_{\overline{t_{0.2}}|}} = \frac{\delta}{1.25^{\delta / \mu} - 1}$$