

EXAM M QUESTIONS OF THE WEEK

S. Broverman, 2006

Week of April 3/06

Aggregate claims S follow a compound distribution with a Poisson frequency distribution N with mean 1, and a geometric severity distribution X with probability function

$$P(X = j) = \frac{\beta^j}{(1+\beta)^{1+j}}, \text{ for } j = 0, 1, 2, \dots$$

It is found that $E[S|S > 0] = \frac{1}{2-2e^{-1/3}}$.

Determine $E(X)$.

The solution can be found below.

Week of April 3/06 - Solution

$$E(X) = \beta .$$

S is a non-negative integer-valued random variable with probability function

$$P(S = k) = g_k .$$

$$E[S|S > 0] = \sum_{k=1}^{\infty} k \cdot P(S = k|S > 0) = \sum_{k=1}^{\infty} k \cdot \frac{P(S=k)}{1-P(S=0)} = \frac{E(S)}{1-P(S=0)} .$$

The severity distribution is geometric with $P(X = 0) = \frac{1}{1+\beta}$.

$$E(S) = E(N) \cdot E(X) = (1)(\beta) = \beta .$$

$$\begin{aligned} P(S = 0) &= g_0 = \sum_{k=0}^{\infty} P(S = 0|N = k) \cdot P(N = k) \\ &= \sum_{k=0}^{\infty} P(X_1 = 0 \cap X_2 = 0 \cap \dots \cap X_k = 0|N = k) \cdot P(N = k) = \sum_{k=0}^{\infty} \frac{(\frac{1}{1+\beta})^k e^{-1}(1)^k}{k!} \\ &= e^{-1} \cdot e^{1/(1+\beta)} = e^{-\beta/(1+\beta)} . \end{aligned}$$

$$E[S|S > 0] = \frac{E(S)}{1-P(S=0)} = \frac{\beta}{1-e^{-\beta/(1+\beta)}} = \frac{1}{2-2e^{-1/3}} = \frac{.5}{1-e^{-.5/(1+.5)}} .$$

We see that $\beta = .5$.