Contents

	Pre	face	page ix
1	Introduction and life insurance practice		1
	1.1	Introduction	1
	1.2	The life insurance market	1
	1.3		4
	1.4		6
	1.5	Unit-linked insurance and beyond	9
2	Technical reserves and market values		11
	2.1	Introduction	11
	2.2	The traditional composition of the liability	12
	2.3	The market-based composition of the liability	18
	2.4	The liabilities and principles for valuation	21
	2.5	The liability and the payments	27
	2.6	The surrender option	30
	2.7	The free policy option	37
3	Interest rate theory in insurance		45
	3.1	Introduction	45
	3.2	Valuation by diversification revisited	46
	3.3	Zero coupon bonds and interest rate theory	58
	3.4	A numerical example	65
	3.5	Bonds, interest and duration	71
	3.6	On the estimation of forward rates	74
	3.7	Arbitrage-free pricing in discrete time	78
	3.8	Models for the spot rate in continuous time	93
	3.9	Market values in insurance revisited	98

vi Contents

4	Bon	us, binomial and Black-Scholes	101
	4.1	Introduction	101
	4.2	Discrete-time insurance model	103
	4.3	The binomial model	115
	4.4	The Black-Scholes model	124
	4.5	Continuous-time insurance model	131
	4.6	Generalizations of the models	143
5	Integrated actuarial and financial valuation		
	5.1	Introduction	146
	5.2	Unit-linked insurance	148
	5.3	The policy holder's account	152
	5.4	Hedging integrated risks under diversification	161
	5.5	Hedging integrated risk in a one-period model	163
	5.6	The multi-period model revisited	172
	5.7	Hedging integrated risks	177
	5.8	Traditional life insurance	199
6	Surplus-linked life insurance		200
	6.1	Introduction	200
	6.2	The insurance contract	203
	6.3	Surplus	210
	6.4	Surplus-linked dividends	215
	6.5	Dividends linear in surplus	217
	6.6	Bonus	222
	6.7	Surplus- and bonus-linked dividends	226
	6.8	Dividends linear in surplus and bonus	229
7	Interest rate derivatives in insurance		235
	7.1	Introduction	235
	7.2	Swaps and beyond in continuous time	236
	7.3	Pricing of interest rate derivatives	240
	7.4	Swaps and beyond in discrete time	246
	7.5	A brief introduction to market models	254
	7.6	Interest rate derivatives in insurance	257
	7.7	A portfolio of contracts	257

Contents	vii

Appendix			
A.1	Some results from probability theory	263	
A.2	The risk-minimizing strategy	266	
A.3	Risk minimization for unit-linked contracts	267	
A.4	Mean-variance hedging for unit-linked contracts	269	
References		272	
Index		278	