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# ACTEX

## Exam P Study Manual



Spring 2019 Edition

Samuel A. Broverman, Ph.D., ASA

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## INTRODUCTORY COMMENTS

This study guide is designed to help in the preparation for the Society of Actuaries Exam P. The study manual is divided into two main parts. The first part consists of a summary of notes and illustrative examples related to the material described in the exam catalog as well as a series of problem sets and detailed solutions related to each topic. Many of the examples and problems in the problem sets are taken from actual exams (and from the sample question link posted on the SOA website). Note that the symbol "  $\square$  " will denote the end of an example.

The second part of the study manual consists of twelve practice exams, with detailed solutions, which are designed to cover the range of material that will be found on the exam. The questions on these practice exams are not from old Society exams and may be somewhat more challenging, on average, than questions from previous actual exams. Between the section of notes and the section with practice exams I have included the normal distribution table provided with the exam.

I have attempted to be thorough in the coverage of the topics upon which the exam is based. I have been, perhaps, more thorough than necessary on a couple of topics, particularly order statistics in Section 9 of the notes and some risk management topics in Section 10 of the notes.

Section 0 of the notes provides a brief review of a few important topics in calculus and algebra. This manual will be most effective, however, for those who have had courses in college calculus at least to the sophomore level and courses in probability to the sophomore or junior level.

If you are taking Exam P for the first time, be aware that a most crucial aspect of the exam is the limited time given to take the exam (3 hours). It is important to be able to work very quickly and accurately. Continual drill on important concepts and formulas by working through many problems will be helpful. It is also very important to be disciplined enough while taking the exam to avoid spending an inordinate amount of time on any one question. If the formulas and reasoning that will be needed to solve a particular question are not clear within 2 or 3 minutes of starting the question, it should be abandoned (and returned to later if time permits). Using the exams in the second part of this study manual and simulating exam conditions will also help give you a feeling for the actual exam experience.

If you have any comments, criticisms or compliments regarding this study guide, please contact the publisher, ACTEX, or you may contact me directly at the address below. I apologize in advance for any errors, typographical or otherwise, that you might find, and it would be greatly appreciated if you bring them to my attention. Any errors that are found will be posted in an errata file at the ACTEX website, [www.actexmadriver.com](http://www.actexmadriver.com).

It is my sincere hope that you find this study guide helpful and useful in your preparation for the exam. I wish you the best of luck on the exam.

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# **NOTES, EXAMPLES AND PROBLEM SETS**

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SECTION 0 - REVIEW OF ALGEBRA AND CALCULUS

In this introductory section, a few important concepts that are preliminary to probability topics will be reviewed. The concepts reviewed are set theory, graphing an inequality in two dimensions, properties of functions, differentiation, integration and geometric series. Students with a strong background in calculus who are familiar with these concepts can skip this section.

## SET THEORY

A **set** is a collection of **elements**. The phrase " $x$  is an element of  $A$ " is denoted by  $x \in A$ , and " $x$  is not an element of  $A$ " is denoted by  $x \notin A$ .

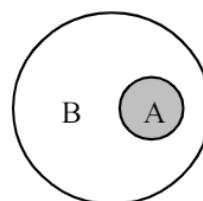
**Subset of a set:**  $A \subset B$  means that each element of the set  $A$  is an element of the set  $B$ .

$B$  may contain elements which are not in  $A$ , but  $A$  is totally contained within  $B$ . For instance, if  $A$  is the set of all odd, positive integers, and  $B$  is the set of all positive integers, then

$$A = \{1, 3, 5, \dots\} \text{ and } B = \{1, 2, 3, \dots\}.$$

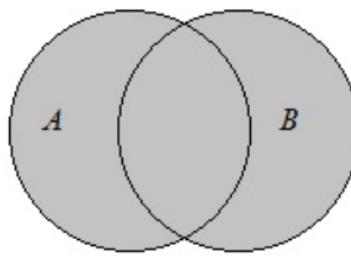
The notation  $A \subseteq B$  also denotes that  $A$  is a subset of  $B$  but that  $A$  may be equal to  $B$ .

For these two sets it is easy to see that  $A \subset B$ , since any member of  $A$  (any odd positive integer) is a member of  $B$  (a positive integer). The Venn diagram below illustrates  $A$  as a subset of  $B$ .



**Union of sets:**  $A \cup B$  is the set of all elements in either  $A$  or  $B$  (or both).

$$A \cup B = \{x \mid x \in A \text{ or } x \in B\}$$



$$A \cup B$$

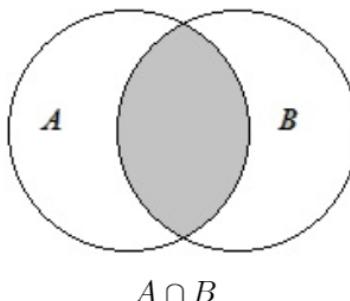
If  $A$  is the set of all positive even integers ( $A = \{2, 4, 6, 8, 10, 12, \dots\}$ ) and  $B$  is the set of all positive integers which are multiples of 3 ( $B = \{3, 6, 9, 12, \dots\}$ ), then

$$A \cup B = \{2, 3, 4, 6, 8, 9, 10, 12, \dots\}$$

is the set of positive integers which are either multiples of 2 or are multiples of 3 (or both).

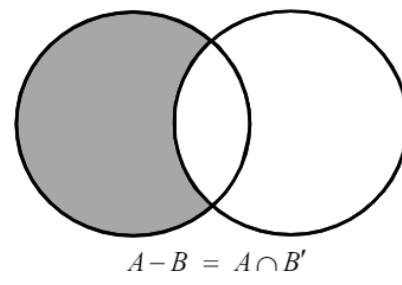
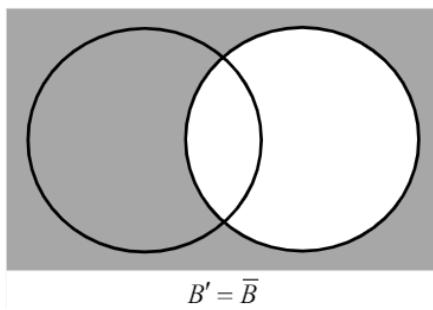
**Intersection of sets:**  $A \cap B$  is the set of all elements that are in both  $A$  and  $B$ .

$$A \cap B = \{x \mid x \in A \text{ and } x \in B\}$$



If  $A$  is the set of all positive even integers and  $B$  is the set of all positive integers which are a multiple of 3, then  $A \cap B = \{6, 12, \dots\}$  is the set of positive integers which are a multiple of 6. The elements of  $A \cap B$  must satisfy the properties of **both**  $A$  and  $B$ . In this example, that means an element of  $A \cap B$  must be a multiple of 2 and must also be a multiple of 3, and therefore must be a multiple of 6.

**The complement of the set  $B$ :** The complement of  $B$  consists of all elements **not in  $B$** , and is denoted  $B'$ ,  $\bar{B}$  or  $\sim B$ .  $B' = \{x \mid x \notin B\}$ . When referring to the complement of a set, it is usually understood that there is some "full set", and the complement of  $B$  consists of the elements of the full set which are not in  $B$ . For instance, if  $B$  is the set of all positive even integers, and if the "full set" is the set of all positive integers, then  $B'$  consists of all positive odd integers. The set difference of "set  $A$  minus  $B$ " is  $A - B = \{x \mid x \in A \text{ and } x \notin B\}$  and consists of all elements that are in  $A$  but not in  $B$ . Note that  $A - B = A \cap B'$ .  $A - B$  can also be described as the set that results when the intersection  $A \cap B$  is removed from  $A$ .



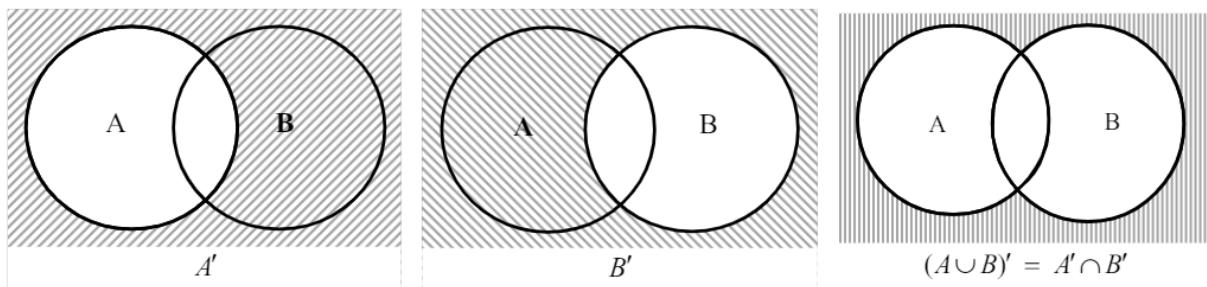
### Example 0-1:

Verify the following set relationships (DeMorgan's Laws):

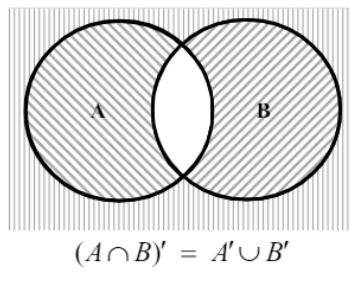
- (i)  $(A \cup B)' = A' \cap B'$  (the complement of the union of  $A$  and  $B$  is the intersection of the complements of  $A$  and  $B$ )
- (ii)  $(A \cap B)' = A' \cup B'$  (the complement of the intersection of  $A$  and  $B$  is the union of the complements of  $A$  and  $B$ )

**Solution:**

- (i) Since the union of  $A$  and  $B$  consists of all points in either  $A$  or  $B$ , any point not in  $A \cup B$  is in neither  $A$  nor  $B$ , and therefore must be in both the complement of  $A$  and the complement of  $B$ ; this is the intersection of  $A'$  and  $B'$ . The reverse implication holds in a similar way; if a point is in the intersection of  $A'$  and  $B'$  then it is not in  $A$  and it is not in  $B$ , so it is not in  $A \cup B$ , and therefore it is in  $(A \cup B)'$ . Therefore,  $(A \cup B)'$  and  $A' \cap B'$  consist of the same collection of points, they are the same set.



- (ii) The solution is very similar to (i).



□

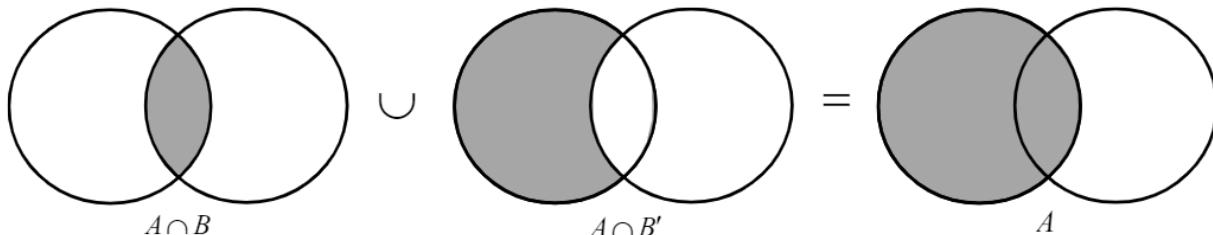
**Empty set:** The **empty set** is the set that contains no elements, and is denoted  $\emptyset$ . It is also referred to as the **null set**. Sets  $A$  and  $B$  are called **disjoint sets** if  $A \cap B = \emptyset$  (they have no elements in common).

**Relationships involving sets:**

1.  $A \cup B = B \cup A$ ;  $A \cap B = B \cap A$ ;  $A \cup A = A$ ;  $A \cap A = A$
2. If  $A \subset B$ , then  $A \cup B = B$  and  $A \cap B = A$  (this can be seen from the Venn diagram in the paragraph above describing subset)
3. For any set  $A$ ,  $\emptyset \subset A$  (the empty set is a subset of any other set  $A$ )
4.  $A \cup \emptyset = A$ ;  $A \cap \emptyset = \emptyset$ ;  $A - \emptyset = A$
5.  $A \cap (B \cup C) = (A \cap B) \cup (A \cap C)$
6.  $A \cup (B \cap C) = (A \cup B) \cap (A \cup C)$
7. For any sets  $A$  and  $B$ ,  $A \cap B \subset A \subset A \cup B$  and  $A \cap B \subset B \subset A \cup B$
8.  $(A \cup B)' = A' \cap B'$  and  $(A \cap B)' = A' \cup B'$

An important rule (that follows from point 4 above) is the following.

For any two sets  $A$  and  $B$ , we have  $A = (A \cap B) \cup (A \cap B')$ .



Related to this is the property that if a finite set is made up of the union of disjoint sets, then the number of elements in the union is the sum of the numbers in each of the component sets.

For a finite set  $S$ , we define  $n(S)$  to be the number of elements in  $S$ .

Two useful relationships for counting elements in a set are  $n(A) = n(A \cap B) + n(A \cap B')$  (true since  $A \cap B$  and  $A \cap B'$  are disjoint), and

$n(A \cup B) = n(A) + n(B) - n(A \cap B)$  (cancels the double counting of  $A \cap B$ ).

This rule can be extended to three sets:

$$\begin{aligned} n(A \cup B \cup C) &= n(A) + n(B) + n(C) \\ &\quad - n(A \cap B) - n(A \cap C) - n(B \cap C) \\ &\quad + n(A \cap B \cap C) \end{aligned}$$

The main application of set algebra is in a probability context in which we use set algebra to describe events and combinations of events (this appears in the next section of this study guide). An understanding of set algebra and Venn diagram representations can be quite helpful in describing and finding event probabilities.

### Example 0-2:

Suppose that the "total set"  $S$  consists of the possible outcomes that can occur when tossing a six-faced die. Then  $S = \{1, 2, 3, 4, 5, 6\}$ . We define the following subsets of  $S$ :

$A = \{1, 2, 3\}$  (a number less than 4 is tossed),

$B = \{2, 4, 6\}$  (an even number is tossed),

$C = \{4\}$  (a 4 is tossed).

Then  $A \cup B = \{1, 2, 3, 4, 6\}$ ;  $A \cap B = \{2\}$ ;

$A$  and  $C$  are disjoint since  $A \cap C = \emptyset$ ;  $C \subset B$ ;

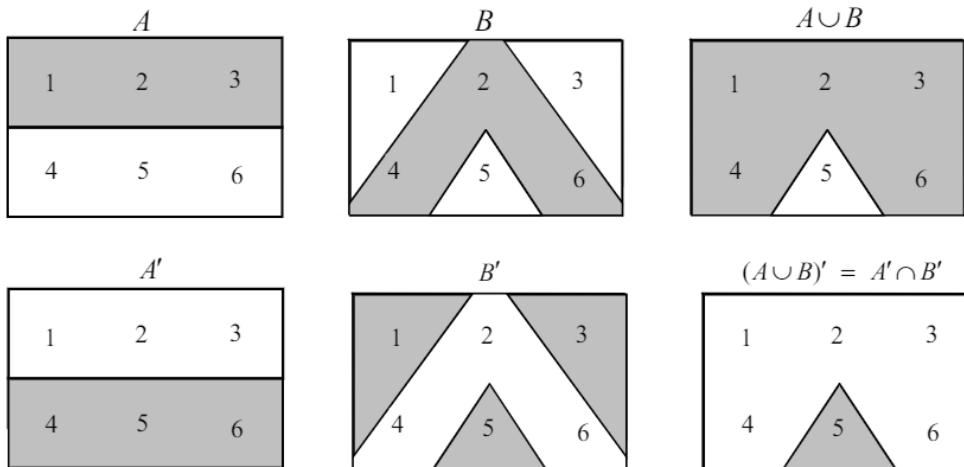
$A' = \{4, 5, 6\}$  (complement of  $A$ );  $B' = \{1, 3, 5\}$ ;  $A \cup B = \{1, 2, 3, 4, 6\}$ ; and

$(A \cup B)' = \{5\} = A' \cap B'$  (this illustrates one of DeMorgan's Laws).

This is illustrated in the following Venn diagrams with sets identified by shaded regions.

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□

Venn diagrams can sometimes be useful when analyzing the combinations of intersections and unions of sets and the numbers of elements in various. The following examples illustrates this.

### Example 0-3:

A heart disease researcher has gathered data on 40,000 people who have suffered heart attacks. The researcher identifies three variables associated with heart attack victims:

$A$  - smoker ,       $B$  - heavy drinker ,       $C$  - sedentary lifestyle .

The following data on the 40,000 victims has been gathered:

29,000 were smokers ; 25,000 were heavy drinker ; 30,000 had a sedentary lifestyle ;  
 22,000 were both smokers and heavy drinkers ;  
 24,000 were both smokers and had a sedentary lifestyle ;  
 20,000 were both heavy drinkers and had a sedentary lifestyle ; and  
 20,000 were smokers, and heavy drinkers and had a sedentary lifestyle.

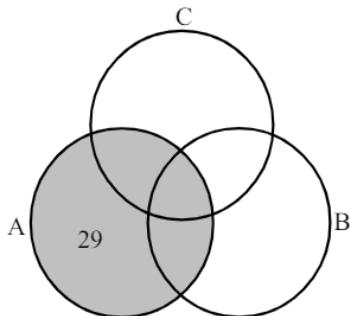
Determine how many victims were:

- (i) neither smokers, nor heavy drinkers, nor had a sedentary lifestyle;
- (ii) smokers but not heavy drinkers;
- (iii) smokers but not heavy drinkers and did not have a sedentary lifestyle?
- (iv) either smokers or heavy drinkers (or both) but did not have a sedentary lifestyle?

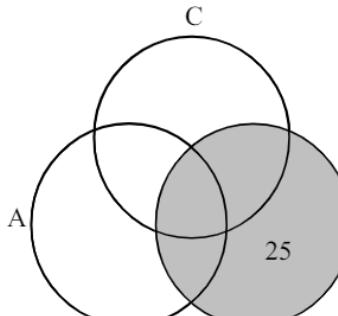
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**Solution:**

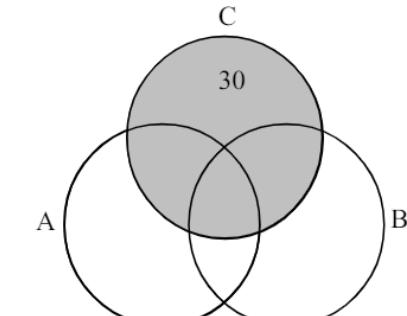
It is convenient to represent the data in Venn diagram form. For a subset  $S$ ,  $n(S)$  denotes the number of elements in that set (in thousands). The given information can be summarized in Venn diagram form as follows:



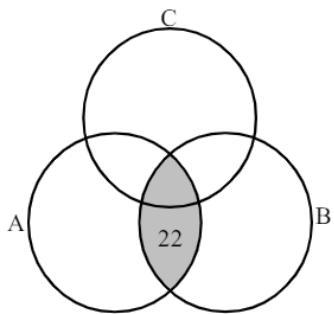
$$n(A) = 29,000 \text{ (smoker)}$$



$$n(B) = 25,000 \text{ (heavy drinker)}$$

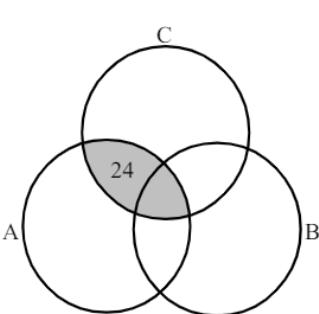


$$n(C) = 30,000 \text{ (sedentary lifestyle)}$$



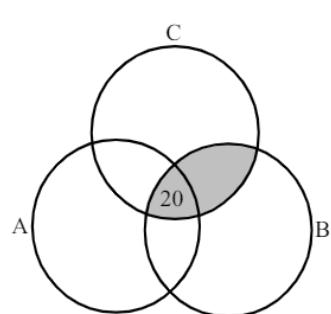
$$n(A \cap B) = 22,000$$

(smoker and heavy drinker)



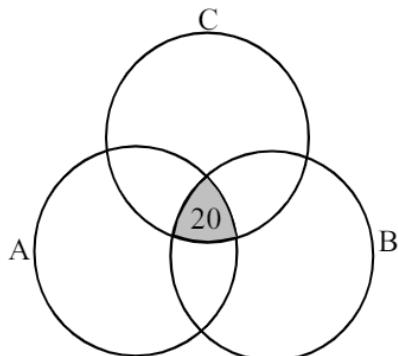
$$n(A \cap C) = 24,000$$

(smoker and sedentary lifestyle)



$$n(B \cap C) = 20,000$$

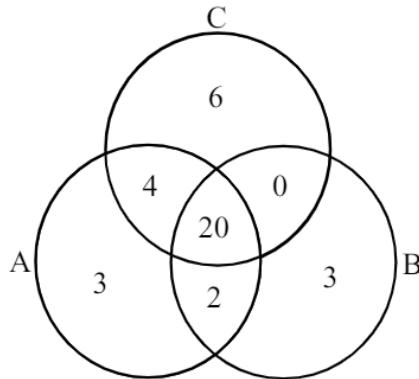
(heavy drinker and sedentary lifestyle)



$$(A \cap B \cap C) = 20,000$$

(smoker and heavy drinker and sedentary lifestyle)

Working from the inside outward in the Venn diagrams, we can identify the number within each minimal subset of all of the intersections:



A typical calculation to fill in this diagram is as follows. We are given  $n(A \cap B \cap C) = 20,000$  and  $n(A \cap B) = 22,000$ ; we use the relationship

$$22,000 = n(A \cap B) = n(A \cap B \cap C) + n(A \cap B \cap C') = 20,000 + n(A \cap B \cap C')$$

to get  $n(A \cap B \cap C') = 2,000$  (this shows that the 22,000 victims in  $A \cap B$  who are both smokers and heavy drinker can be subdivided into those who also have a sedentary lifestyle  $n(A \cap B \cap C) = 20,000$ , and those who do not have a sedentary lifestyle,  $n(A \cap B \cap C')$ , the other = 2,000). Other entries are found in a similar way. From the diagram we can gain additional insight into other combinations of subsets. For instance, 6,000 of the victims have a sedentary lifestyle, but are neither smokers nor heavy drinkers; this is the entry "6", which in set notation is  $n(A' \cap B' \cap C) = 6,000$ . Also, the number of victims who were both heavy drinkers and had a sedentary lifestyle but were not smokers is 0.

We can now find the requested numbers.

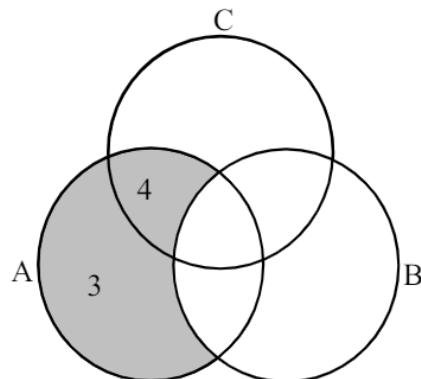
- (i) The number of victims who had at least one of the three specified conditions is  $n(A \cup B \cup C)$ , which, from the diagram can be calculated from the disjoint components:

$$n(A \cup B \cup C) = 20,000 + 2,000 + 4,000 + 0 + 3,000 + 3,000 + 6,000 = 38,000.$$

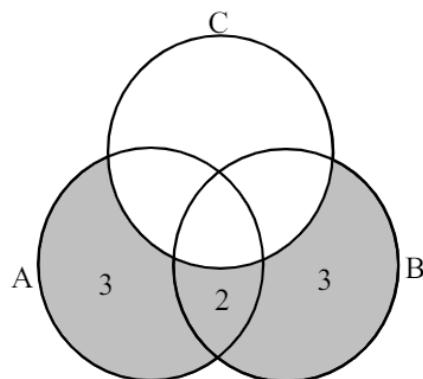
The "total set" in this example is the set of all 40,000 victims. Therefore, there were 2,000 heart attack victims who had none of the three specified conditions; this is the complement of  $n(A \cup B \cup C)$ .

Algebraically, we have used the extension of one of DeMorgan's laws to the case of three sets, "none of  $A$  or  $B$  or  $C$ " =  $(A \cup B \cup C)' = A' \cap B' \cap C' =$  "not  $A$ " and "not  $B$ " and "not  $C$ ".

- (ii) The number of victims who were smokers but not heavy drinkers is  $n(A \cap B') = 3,000 + 4,000$ . This can be seen from the following Venn diagram



- (iii) The number of victims who were smokers but not heavy drinkers and did not have a sedentary lifestyle is  $n(A \cap B' \cap C') = 3,000$  (part of the group in (ii)).
- (iv) The number of victims who were either smokers or heavy drinkers (or both) but did not have a sedentary lifestyle is  $n[(A \cup B) \cap C']$ . This is illustrated in the following Venn diagram.



$$n[(A \cup B) \cap C'] = 3,000 + 2,000 + 3,000 = 8,000.$$

□

## GRAPHING AN INEQUALITY IN TWO DIMENSIONS

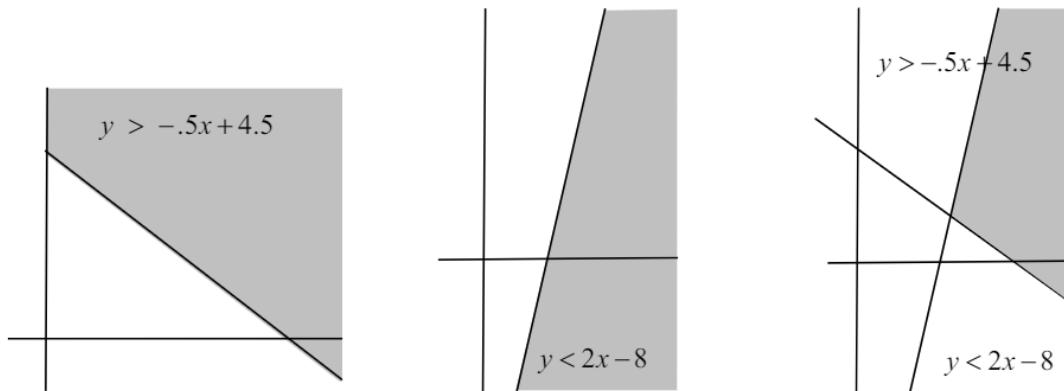
The joint distribution of a pair of random variables  $X$  and  $Y$  is sometimes defined over a two dimensional region which is described in terms of linear inequalities involving  $x$  and  $y$ . The region represented by the inequality  $y > ax + b$  is the region above the line  $y = ax + b$  (and  $y < ax + b$  is the region below the line).

**Example 0-4:** Using the lines  $y = -\frac{1}{2}x + \frac{9}{2}$  and  $y = 2x - 8$ , find the region in the  $x$ - $y$  plane that satisfies both of the inequalities  $y > -\frac{1}{2}x + \frac{9}{2}$  and  $y < 2x - 8$ .

**Solution:**

We graph each of the straight lines, and then determine which side of the line is represented by the inequality. The first graph below is the graph of the line  $y = -\frac{1}{2}x + \frac{9}{2}$ , along with the shaded region, which is the region  $y > -\frac{1}{2}x + \frac{9}{2}$ , consisting of all points "above" that line. The second graph below is the graph of the line  $y = 2x - 8$ , along with the shaded region, which is the region  $y < 2x - 8$ , consisting of all points "below" that line.

The third graph is the intersection (first region and second region) of the two regions. Although the boundary lines of the regions in the graphs are solid lines, the inequalities are strict inequalities.



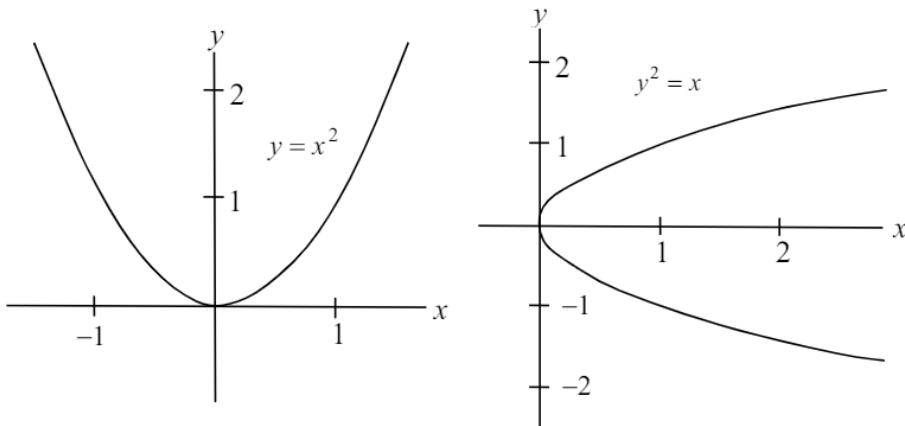
□

## PROPERTIES OF FUNCTIONS

**Definition of a function  $f$ :** A function  $f(x)$  is defined on a subset (or the entire set) of real numbers. For each  $x$ , the function defines a number  $f(x)$ . The **domain** of the function  $f$  is the set of  $x$ -values for which the function is defined. The **range of  $f$**  is the set of all  $f(x)$  values that can occur for  $x$ 's in the domain. Functions can be defined in a more general way, but we will be concerned only with real valued functions of real numbers. Any relationship between two real variables (say  $x$  and  $y$ ) can be represented by its graph in the  $(x, y)$ -plane. If the function  $y = f(x)$  is graphed, then for any  $x$  in the domain of  $f$ , the vertical line at  $x$  will intersect the graph of the function at exactly one point; this can also be described by saying that for each value of  $x$  there is (at most) one related value of  $y$ .

### Example 0-5:

- (i)  $y = x^2$  defines a function since for each  $x$  there is exactly one value  $x^2$ . The domain of the function is all real numbers (each real number has a square). The range of the function is all real numbers  $\geq 0$ , since for any real  $x$ , the square is  $x^2 \geq 0$ .
- (ii)  $y^2 = x$  does not define a function since if  $x > 0$ , there are two values of  $y$  for which  $y^2 = x$ . These two values are  $\pm\sqrt{x}$ . This is illustrated in the graphs below



□

### Functions defined piecewise:

A function that is defined in different ways on separate intervals is called a **piecewise defined function**. The absolute value function is an example of a piecewise defined function:

$$|x| = \begin{cases} -x & \text{for } x < 0 \\ x & \text{for } x \geq 0 \end{cases}$$