OPTIMAL INVESTMENT AND PROPORTIONAL REINSURANCE STRATEGY UNDER THE MEAN-REVERTING ORNSTEIN-UHLENBECK PROCESS AND NET PROFIT CONDITION

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(Communicated by Kok Lay Teo)

Abstract. In this study, under the criterion of maximizing the expected exponential utility of terminal wealth, the optimal proportional reinsurance and investment strategy for an insurer is examined with the compound Poisson claim process. To make the model more realistic, the price process of the risky asset is modelled by the Brownian motion risk model with dividends and transaction costs, where the instantaneous of investment return follows as a mean-reverting Ornstein-Uhlenbeck process. At the same time, the net profit condition and variance reinsurance premium principle are also considered. Using stochastic control theory, explicit expressions for the optimal policy and value function are derived, and various numerical examples are given to further demonstrate the effectiveness of the model.

1. Introduction. The insurance company is an important link of the social development. They are committed to the risk protection for the public and society by providing persons and property insurance service, and get returns by using premiums in the investment of bonds, stocks, loans and other financial assets. However, profit always comes with risk. Sometimes, ruin will occur when a claim is greater

2020 Mathematics Subject Classification. Primary: 90B50, 93E20; Secondary: 91G80.
Key words and phrases. Proportional reinsurance, Compound Poisson process, Mean reverting process, Stochastic control, Variance reinsurance premium, Net profit condition.

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than the surplus of the company. Accordingly, how to make effective investment strategies that maximize profits and minimize risk, e.g. the proportion setting of investment and reinsurance, is the core competitiveness of an insurance which restricts their vitality and development. In the past decade, lots of scholars established variety of risk models to settle down the problem in the optimization of investment and reinsurance ([1, 2, 3, 4]). By using stochastic control method and related methodologies, the minimum ruin probability or the maximum expected utility of terminal wealth were obtained (for information on these issues, see [5, 6, 7, 8, 9, 10]). However, due to the uncertainty of risks, these methods are rarely used in reality. Insurance companies still take control of risky asset investments and proportional reinsurance purchases (for information on these issues, see [11, 12, 13]).

The recent trend in the study of investment strategies for insurance companies is to design the reasonable proportion of investment and reinsurance. By building a Brownian risk model, Promislow and Young [14] derived an analytical expression for minimizing the probability of ruin and the related optimal controls. Luo et al. [15] obtained the optimal strategy with the minimum ruin probability which investment includes one risk free asset and one risky asset. Bai and Guo [16] researched the optimal reinsurance problem where investment includes multiple risky assets and no-shorting constraint. Based on their results, when we do not invest the risk-free assets, the benefit from minimizing the probability of ruin is equal to that from maximizing the expected exponential utility. Additionally, for a compound Poisson risk model with diffusion process, Liang and Guo [17] researched the optimal strategy for maximizing the adjustment coefficient.

In the simulation of price process, besides the geometric Brownian motion, other type of random processes are also used for actuarial analysis. Irgens and Paulsen [18] investigated the optimal reinsurance and investments under the return of risky assets being a jump-diffusion process. Kostadinova [19] studied on the price of the risky asset and obtained an approximation of the optimal investment strategy by using a general exponential Lévy process, which maximizes the expected terminal wealth. Baev and Bondarev [20] discussed a risk model to settle down the portfolio problem, where the stock price is not affected by the standard Brownian motion, but the Ornstein-Uhlenbeck (O-U) process. Chen et al. [21] investigated the optimal investment problem with a risky asset which the stock price is affected by the random factor, e.g. the financial crisis and the changes of policy and interest; and they derived optimization for maximizing profit by using mean-variance hedging, which is a form of variance optimal martingale measure by changing the filtration. Liang et al. [22] considered maximizing the excepted exponential utility of the terminal problem, which the drift process follows an O-U process; and they obtained the closed expression of the optimal investment strategy. Wang and Peng [23] researched the problem of optimal reinsurance and investment, which the risk is measured by distortion risk measures. The premiums are calculated under the distortion premium principle, and both the upper and lower premium constraints are involved.

Analyzing the research results in the field of insurance strategy, we conclude that the existing references neglect the impact of the current operation status of insurance companies (bankruptcy or excess earnings) on reinsurance investment (also see [24, 25, 26, 27] and references therein). Specifically, Lindensjø currently use a unified approach for partial information optimal investment and consumption problems for a general Itô process model [28]. Meanwhile, they also ignore the effect...
of mean reverting feature in asset price on reinsurance returns. These gaps are neither conducive to the insurance companies to choose investment strategies reasonably nor help to these companies to obtain long-term returns. In this paper, we consider a model for a stock price which can have features of bull and bear markets. By assuming that the interest rate of the underlying price is a stochastic process rather than a constant, it becomes possible to more accurately model derivatives. Mean-reverting O-U stochastic interest rate model is used in the fields of quantitative finance and financial engineering to evaluate derivative securities, such as the variance of the price returns of stock and the option price. Therefore, this paper will improve and optimize the existing studies in the following three aspects. The optimal reinsurance model analysed in this article is closely related to work by Baev and Bondarev [20] and Liang et al. [22]. There are, however, several important differences. First, the net profit condition is added in the process of decision-making, which describes the impact of the company’s operation status on investment strategy. Additionally, under the condition of net profit, the reinsurance proportion is taken as the threshold to realize the classified reinsurance investment which provides more accurate investment strategy for insurance company. Second, a mean-reverting O-U process instead of a general O-U process is used in simulating the trends of asset price, which reduces the expected loss of returns from the structural risk in financial market caused by non-systematic deviation and ensures that insurance companies can obtain absolute profits in the long run. Third, on the basis of traditional average return model, the stock return and transaction are independently added on the return item, which makes the income model more reliable in fitting the actual trading of the insurance market.

The remainder of this article is organized as follows. Section 2 introduces several assumptions and the optimal reinsurance model with the mean-reverting O-U process. Section 3 introduces the solution to the proposed model and explicitly derives the optimal investment and reinsurance strategy. Section 4 provides numerical examples to illustrate the applicability of the theoretical result and the value of the optimal reinsurance strategy. Section 5 summarizes the conclusion, limitation, and future research.

2. Model formulation. We suppose the aggregate claim amount model $M (t)$ is compound Poisson model. The surplus process is given by

$$M (t) = u + mt - Z (t) = u + mt - \sum_{i=1}^{N(t)} Y_i$$

or

$$dM (t) = m dt - dZ (t),$$

where $u$ is the initial capital, $m$ is the insurer premium rate. The claim arrival process $\{N(t): t \geq 0\}$ is a Poisson process with parameter $\lambda$ and the claim sizes $\{Y_i: i \geq 1\}$ which are independent and identically distributed, positive, and independent of $\{N(t)\}$. For convenience, let $Y$ denote a generic random variable which has the same law as $Y_i$. Denote the mean and moment generating function of $Y$ by $\mu_Y = EY (t)$ and $M_Y (\rho) = E(e^{\rho Y})$ respectively. In order to ensure the true of the following lemma, here we make the special hypothesis of $Y$. We assume that $E(Y e^{\rho Y}) = M^Y_Y (\rho)$ exits for $0 < \rho < \zeta$ with $\lim_{\rho \rightarrow \zeta} E(Y e^{\rho Y}) = \infty$ for some $0 < \zeta \leq +\infty$. 

...
To transfer certain risks, we suppose the insurer purchases the proportional reinsurance. Thus, the retention function is denoted by an adapted process $q(t) \in [0, 1]$, where $q(t)$ is the retention level and $\delta(q(t))$ is the premium payment of reinsurance. Throughout this paper, we assume that the reinsurance premium is calculated according to the variance principle. That is

$$
\delta(q(t)) = (1 - q(t)) \lambda \mu_1 + \Lambda(1 - q(t))^2 \lambda \mu_2,
$$

where $\mu_2 = E(Y^2)$ and $\Lambda(>0)$ is the safety loading of the reinsurer. Because it is necessary to guarantee non-cheap reinsurance conditions and the normal operation of the insurance company, we assume that the net profit condition is not less than 0. Denoting the insurer safety loading by $\xi = \left(\frac{m \lambda \mu_1}{\lambda \mu_2} \right) \frac{1}{\Lambda}$ which satisfies the general condition $\Lambda > \xi \geq 0$, the net profit condition is

$$
m - \delta(q(t)) - q(t) \lambda \mu_1
= m - (1 - q(t)) \lambda \mu_1 - \Lambda(1 - q(t))^2 \lambda \mu_2 - q(t) \lambda \mu_1
= m - \lambda \mu_1 - \Lambda(1 - q(t))^2 \lambda \mu_2 \geq 0,
$$

so

$$
1 - q(t) \leq \sqrt{\frac{m - \lambda \mu_1}{\lambda \mu_2 \Lambda}},
$$

$$
q(t) \geq 1 - \sqrt{\frac{m - \lambda \mu_1}{\lambda \mu_2 \Lambda}},
$$

$$
q(t) \geq 1 - \sqrt{\frac{\xi}{\Lambda}}.
$$

Letting $\bar{q} = 1 - \sqrt{\frac{\xi}{\Lambda}}$, $\bar{q}$ is the threshold, which plays an important role in the paper. The positive value of the net profit condition indicates the maximum or minimum value of a certain economic factor that can reach in a certain period of time. The threshold, which is calculated by the net profit condition, is defined as the limitation of the positive returns for the insurance companies in the long term. In this paper, we assume that the claim model is a jump-diffusion model, which can better describe the influence of insurer competition and other factors on the insurer’s earning process. So the surplus process becomes

$$
dM^q(t) = [m - \delta(q(t))] dt + \gamma dW^{(1)}(t) - q(t) dZ(t),
$$

where $\gamma \geq 0$ is a constant, $W^{(1)}(t)$ is a standard Brownian motion independent of the $Y_i$ ($i \geq 1$) and of claim number process $N(t)$. The diffusion term $\gamma dW^{(1)}(t)$ represents the additional uncertainty associated with the economic environment or the insurance market. Because the uncertainty is not necessarily related to the claims, so we only consider that $\gamma dW^{(1)}(t)$ is not affected by reinsurance at all.

In this paper, the insurer is allowed to invest its surplus in a financial market consisting of risky asset (stock or mutual fund) and a risk-free asset (bond or bank account). According to [30], we also suppose that the $c$ represents the dividend income of insurance companies from stock holding. The transaction cost is $\theta$, which consists of fees and stamp duty. So, the riskless price process is given by

$$
dS_0(t) = rS_0(t) dt,$$
where \( r (> 0) \) is a risk-free interest. In the existing literature, stock price follows a geometric Brownian motion. That is, a stock price \( S(t) \) satisfies a stochastic differential equation

\[
dS(t) = (\bar{a} + c - \theta) S(t) \, dt + \sigma S(t) \, dW^{(2)}(t),
\]

where \( \bar{a} (> r) \) and \( \sigma \) are positive constants, \( \bar{a} (> r) \) represents the expected instantaneous return of the risky asset, \( \sigma \) is the volatility of the risky asset price and \( W^{(2)}(t) \) is a standard Brownian motion. In addition, we assume that \( \bar{a} - \theta + c > r \).

Since the process

\[
(\bar{a} + c - \theta) t + \sigma W^{(2)}(t)
\]

has independent stationary increments, the stock growth have the same statistical properties over any two period of equal length, which appears to rule out bull and bear markets (see Rishel [26]).

In order to make stock model more realistic to the price feature both in bull and bear market, we construct the price process which is similar as the model established by Rishel [26]

\[
dS(t) = (a(t) + c - \theta) S(t) \, dt + \sigma S(t) \, dW^{(2)}(t),
\]

in which \( a(t) \) is a random process. In this model, both the mean growth \( a(t) \, dt \) and the volatility item \( \sigma dW^{(2)}(t) \) are all random process, which \( a(t) \) is a solution of

\[
da(t) = \alpha (\bar{a} - a(t)) \, dt + \beta dW^{(3)}(t), \quad a(0) = a_0,
\]

where \( W^{(3)}(t) \) and \( a_0 \) indicate another standard Brownian motion and an arbitrary constant. We assume that the joint distribution of every two Brownian motions is bivariate normal, and denote by \( \rho_1 \) the correlation coefficient of \( W^{(1)}(t) \) with \( W^{(2)}(t) \), i.e., \( E[W^{(1)}(t), W^{(2)}(t)] = \rho_1 t \). Similarly, denote the correlation coefficient between \( W^{(2)}(t) \) and \( W^{(3)}(t) \) by \( \rho_2 \), that is, \( E[W^{(2)}(t), W^{(3)}(t)] = \rho_2 t \). We will not discuss the uninteresting case of \( \rho_1^2 = 1 \) and \( \rho_2^2 = 1 \), in such case there would only be one source of randomness in the model. Here, the quantities of \( r, \sigma, \bar{a}, b, c, \theta, \alpha \) and \( \beta \) are known constants with positive values. And we also set the values of \( \alpha \) and \( \beta \) as the precondition of the model. Accordingly, if \( \bar{a} \) is a target of the mean growth for the stock, meanwhile, \( a(t) \) is substantially larger than \( \bar{a} \), then the price process could be considered as a bull market. Conversely, when \( a(t) \) is substantially less than \( \bar{a} \), the price process could be considered as a bear market.

We assume the total money amount invested in the risky asset is \( A(t) \) at time \( t \); namely, using the investment strategy \( A(t) \), an insurer can obtain the wealth \( V(t) \) at time \( t \). Following the assumptions of Browne [1], we allow \( A(t) < 0 \) and \( A(t) > V(t) \). That is, we allow the company to short sell the risky asset \( A(t) < 0 \), and also allow the company to borrow money for investment in the risky asset \( A(t) > V(t) \). Because we only consider investing in the risky asset and the risk-free asset, the dynamics of \( V(t) \) then takes the form.
We use dynamic programming techniques to solve above problem (see, Fleming and Soner [34]). Define the associated value function by

$$H(t,v,a) = \max_{(A(t),q(t)) \in \Pi} E \left[ U(V(T)) \right] | V(t) = v, a(t) = a].$$

(5)

In order to solve problem (5), we use dynamic programming techniques and in particular the HJB equation. Let $C^{1,2}$ denote the space of $\phi(t,v,a)$ such that $\phi$ and its partial derivatives $\phi_t, \phi_v, \phi_a, \phi_{vv}, \phi_{aa}, \phi_{va}$ continuous on $[0,T] \times R \times R$. The generator for the state process (4) subject to the choice $A(t), q(t)$ has the form

$$dV(t) = A(t) \frac{dS(t)}{S(t)} + (V(t) - A(t)) \frac{dS_0(t)}{S_0(t)} + dM^q(t)
= [A(t)(a(t) + c - \theta - r) + rV(t)] dt
+ [m - \delta(q(t))] dt + \gamma dW^{(1)}(t) + \sigma A(t) dW^{(2)}(t) - q(t) dZ(t)
= [A(t)(a(t) + c - \theta - r) + rV(t) + m - \delta(q(t))] dt
+ \gamma dW^{(1)}(t) + \sigma A(t) dW^{(2)}(t) - q(t) dZ(t),$$

where $\delta(q(t))$ is given in (2).

In this paper, we assume that continuous trading is allowed and all assets are infinitely divisible. In a complete probability space $(\Omega, \mathcal{F}, P)$ where the $V(t)$ is well defined, the information at time $t$ is given by complete filtration $\mathcal{F}(t)$ generated by $V(t)$. If the policy $(A(t), q(t))$ is $\mathcal{F}(t)$-progressively measurable, and satisfies the condition that $E \left[ \int_0^T A^2(t) dt \right] < \infty$, a.s., for all $T < \infty$, we say the strategy is admissible. The set of all admissible strategies is denoted by $\Pi$.

Assume that we invest to maximize the terminal wealth utility at time $T$, and use $U(x)$ to present the utility function as $U''(x) > 0$ and $U'''(x) < 0$. Thus our optimization problem can be described by the following formulation

$$\max E \left[ U(V(T)) \right],$$

(3)

subject to

$$\begin{cases}
    dV(t) = [A(t)(a(t) + c - \theta - r) + rV(t) + m - \delta(q(t))] dt \\
    + \gamma dW^{(1)}(t) + \sigma A(t) dW^{(2)}(t) - q(t) dZ(t), \\
    (A(t), q(t)) \in \Pi, \\
    da(t) = \alpha(\bar{a} - a(t)) dt + \beta dW^{(3)}(t), \quad a(0) = a_0,
\end{cases}$$

(4)

where $\delta(q(t))$ is given in (2).

To model the utility function, prior works provided a variety of methods in investing and decision making (Merton [31] and Karatzas [32]). Here, we apply the method designed by Loubergé and Watt [33] to control the investment risks. Because in the next section we use the exponential utility function. This utility has constant absolute risk aversion parameter $n$.

3. Solution to the Model.

3.1. General Framework. We use dynamic programming techniques to solve above problem (see, Fleming and Soner [34]). Define the associated value function by

$$H(t,v,a) = \max_{(A(t),q(t)) \in \Pi} E \left[ U(V(T)) \right] | V(t) = v, a(t) = a].$$

(5)

In order to solve problem (5), we use dynamic programming techniques and in particular the HJB equation. Let $C^{1,2}$ denote the space of $\phi(t,v,a)$ such that $\phi$ and its partial derivatives $\phi_t, \phi_v, \phi_a, \phi_{vv}, \phi_{aa}, \phi_{va}$ continuous on $[0,T] \times R \times R$. The generator for the state process (4) subject to the choice $A(t), q(t)$ has the form
\[ A^{A,q} \phi(t, v, a) \]
\[ = \phi_t + \left[ A(a + c - \theta - r) + rv + m - (1 - q) \lambda \mu_1 - \Lambda(1 - q)^2 \lambda \mu_2 \right] \phi_v \]
\[ + \alpha (\bar{a} - a) \phi_a + \left[ \frac{1}{2} \left( A^2 \sigma^2 + \gamma^2 + 2A \sigma \gamma \rho_1 \right) \right] \phi_{vv} + \frac{1}{2} \beta^2 \phi_{aa} + \sigma A \beta \rho_2 \phi_{va} \]
\[ + \lambda E \left[ \phi(t, v - qY, a) - \phi(t, v, a) \right] , \]

where \( \phi(t, v, a) \in C^{1,2} \). Thus, we can see that if the value function \( H(t, v, a) \in C^{1,2} \), then \( H(t, v, a) \) satisfies the following HJB equation:
\[ \sup_{A^{A,q}} A^{A,q} H(t, v, a) = 0 \quad (6) \]

for \( t < T \) with the following boundary condition
\[ H(T, v, a) = U(v) , \quad (7) \]

where
\[ A^{A,q} H(t, v, a) \]
\[ = H_t + \left[ A(a + c - \theta - r) + rv + m - (1 - q) \lambda \mu_1 - \Lambda(1 - q)^2 \lambda \mu_2 \right] H_v \]
\[ + \alpha (\bar{a} - a) H_a + \left[ \frac{1}{2} \left( A^2 \sigma^2 + \gamma^2 + 2A \sigma \gamma \rho_1 \right) \right] H_{vv} + \frac{1}{2} \beta^2 H_{aa} + \sigma A \beta \rho_2 H_{va} \]
\[ + \lambda E \left[ H(t, v - qY, a) - H(t, v, a) \right] \]

and \( H_t, H_v, H_a, H_{vv}, H_{aa}, H_{va} \) are the partial derivatives of \( H(t, v, a) \).

The following verification theorem shows that the classical solution to the HJB equation yields the solution to the optimization problem (4).

**Theorem 3.1. (Verification Theorem)** Let \( W \in C^{1,2} \) be concave solution to HJB (6) subject to the boundary Condition (7). Then value function \( H \) given by (5) coincides with \( W \). That is
\[ W(t, v, a) = H(t, v, a) . \]

**Proof.** Since \( \Pi \) be any admissible control system, \( (A(s), q(s)) \) is \( \mathcal{F}(t) \)-progressively measurable,
\[ A^{A(s),q(s)} W(t, V(s), a(s)) = 0 . \]

Similar method as that in Fleming and Soner [34] (Chapter III, Theorem 8.1), from (7) and the Dynkin formula
\[ W(t, v, a) = E \left\{ \int_t^T -A^{A(s),q(s)} W(s, V(s), a(s)) \, ds + U(V(T)) \right\} \]
\[ \leq E \left\{ U(V(T)) \right\} . \]

Taking conditional expectations given \( (t, v, a) \) on both sides of above equation and taking (6) into consideration yields:
\[ W(t, v, a) \leq H(t, v, a) . \]

When \( \Pi = \Pi^* \), the inequality in the above formula becomes an equality, and thus \( W(t, v, a) = H(t, v, a) \). Then, the proof is complete. \( \square \)
Furthermore, let \((A^*, q^* )\) be such that

\[ A^{A^*, q^*} H (t, v, a) = 0 \]

for all \((t, v, a) \in [0, T] \times R \times R\). If \((A^*, q^*)\), together with any initial data \((t, v, a)\), determine a Markov process \((V^* (s), a(t))\) with backward evolution operator \(A^{A^*, q^*}\), then we can take

\[ (A^* (t), q^* (t)) = (A^* (t, V^* (s), a(t)), q^* (t, V^* (s), a(t))) . \]

Once the corresponding control system \(\Pi^*\) is verified to be admissible, \(\Pi^*\) is optimal. When this procedure works, we call \((A^* (t, V^* (t), a(t)), q^* (t, V^* (t), a(t)))\) an optimal Markov control policy. Then the Markovian strategy

\[ (A^* (t, V^* (t), a(t)), q^* (t, V^* (t), a(t))) \]

is optimal with

\[ \max E [U (V^*(T))] V^* (t) = v, a (t) = a = H (t, v, a) . \]

Here, because \(V^* (t)\) is a dynamic asset that is derived under the optimal strategy, which is different from \(V(t)\), so we call \(V^* (t)\) the reserve process.

Accordingly, the function satisfies the HJB function which can use the Theory 3.1. To find the specific solution which satisfies both (6) and (7), we try to use the exponential utility to figure out the classical solution. Here, the exponential utility function is applied because it is a pure utility function when zero utility principle gives a fair premium; namely the terminal wealth defined by this function is independent against the insurance reserve level (Gerber [35]).

3.2. Exponential Utility. Suppose now that the investor has an exponential utility function

\[ U (v) = \lambda_1 - \frac{\eta}{n} e^{-nv}, \]

where the parameters \(\lambda_1, \eta, n\) are positive constants. This utility has constant absolute risk aversion (CARA) parameter \(n\).

Following the methods of Browne [1], we conjecture a solution of the form

\[ H (t, v, a) = \lambda_1 - \frac{\eta}{n} \exp \left[ -nv e^{(T-t)} + G (t, a) \right], \quad (8) \]

where \(G (t, a)\) is a suitable function to be determined. And the boundary condition \(V(T, v, a) = U(x)\) implies that

\[ G (T, a) = 0. \quad (9) \]

Let \(G_t, G_a, G_{aa}\) be the partial derivatives of \(G(t, a)\). Note that

\[
\begin{align*}
H_t &= [H (t, v, a) - \lambda_1] \left[ n v e^{(T-t)} + G_t \right], \\
H_v &= [H (t, v, a) - \lambda_1] \left[ -n e^{(T-t)} \right], \\
H_a &= [H (t, v, a) - \lambda_1] \left[ G_a \right], \\
H_{vv} &= [H (t, v, a) - \lambda_1] \left[ n^2 e^{2(T-t)} \right], \\
H_{aa} &= [H (t, v, a) - \lambda_1] \left[ G_{aa} + G_{aa} \right], \\
H_{va} &= [H (t, v, a) - \lambda_1] \left[ -ne^{(T-t)}G_a \right], \\
E[H (t, v - qY, a) - H (t, v, a)] &= [H (t, v, a) - \lambda_1] \left[ M_y ny e^{(T-t)} - 1 \right]. \\
\end{align*}
\]

Substituting (10) back into the HJB equation (6), since \(H (t, v, a) - \lambda_1 < 0\), we get
\[
\inf_{\lambda, q} \left\{ G_t - \left[ A(a + c - \theta - r) + v + m - (1 - q) \lambda \mu_1 - \Lambda(1 - q)^2 \lambda \mu_2 \right] n e^{r(T-t)} + \alpha (\bar{a} - a) G_a + \frac{1}{2} A^2 \sigma^2 + \gamma^2 + 2A \sigma \gamma \rho_1 \right] n^2 e^{2r(T-t)} + \frac{1}{2} \beta^2 \left[ G_a^2 + G_{aa} \right] + \sigma A \beta \rho_2 \left[ -n e^{r(T-t)} G_a \right] + \lambda \left[ M_Y \left( n e^{r(T-t)} \right) - 1 \right] \right\} = 0
\]
for \( t < T \). Or equivalently,
\[
G_t - m n e^{r(T-t)} - \lambda + \alpha (\bar{a} - a) G_a + \frac{1}{2} \beta^2 \left[ G_a^2 + G_{aa} \right] + \frac{1}{2} n^2 e^{2r(T-t)} \gamma^2 + \inf_A \left\{ -A(a + c - \theta - r) + \frac{1}{2} \sigma^2 A^2 n e^{r(T-t)} + \sigma A \gamma \rho_1 n e^{r(T-t)} - \sigma A \beta \rho_2 G_a \right] n e^{r(T-t)} \}
+ \inf_q \left\{ (1 - q) \lambda \mu_1 - \Lambda(1 - q)^2 \lambda \mu_2 \right] n e^{r(T-t)} + \lambda M_Y \left( n e^{r(T-t)} \right) \bigg\} = 0. \tag{11}
\]

Let
\[
f_1 (A, t) = \left[ -A(a + c - \theta - r) + \frac{1}{2} \sigma^2 A^2 n e^{r(T-t)} + \sigma A \gamma \rho_1 n e^{r(T-t)} - \sigma A \beta \rho_2 G_a \right] n e^{r(T-t)},
\]
and
\[
f_2 (q, t) = \left[ (1 - q) \lambda \mu_1 - \Lambda(1 - q)^2 \lambda \mu_2 \right] n e^{r(T-t)} + \lambda M_Y \left( n e^{r(T-t)} \right). \tag{12}
\]

Differentiating \( f_1 (A, t) \) with respect to \( A \) yields the minimizer
\[
A^* = \frac{(a + c - \theta - r) + \sigma \beta \rho_2 G_a}{\sigma^2 n e^{r(T-t)}} - \frac{\gamma \rho_1}{\sigma},
\]
and the value of \( f_1 (A, t) \) at this minimum is
\[
f_1 (A^*, t) = \frac{(a + c - \theta - r) + \sigma \beta \rho_2 G_a}{\sigma} \gamma \rho_1 n e^{r(T-t)} - \frac{1}{2} \left[ \frac{(a + c - \theta - r) + \sigma \beta \rho_2 G_a}{\sigma^2} \right]^2 \gamma \rho_1 n e^{r(T-t)} \frac{\sigma}{\sigma^2} - \frac{1}{2} \left[ \gamma \rho_1 n e^{r(T-t)} \right]^2.
\]

Similarly, differentiating \( f_2 (q, t) \) with respect to \( q \), we have
\[
\frac{\partial f_2 (q, t)}{\partial q} = n \lambda (1 - q) \lambda \mu_2 - 2 \Lambda (1 - q) \lambda \mu_2 \right] n e^{r(T-t)} + \lambda E \left[ Y e^{n e^{r(T-t)} Y} \right] n e^{r(T-t)},
\]
and
\[
\frac{\partial^2 f_2 (q, t)}{\partial q^2} = \lambda E \left[ n^2 e^{2r(T-t)} Y^2 e^{n e^{r(T-t)} Y} \right] + 2 \Lambda \lambda \mu_2 n e^{r(T-t)} > 0.
\]

Therefore, \( f_2(q, t) \) is a convex function with respect to \( q \), and its minimizer \( q^* \) satisfies the following equation:
\[
M'_Y \left( n e^{r(T-t)} \right) = \mu_1 + 2 \Lambda (1 - q) \mu_2, \tag{13}
\]
where \( M'_Y \left( n e^{r(T-t)} \right) = E \left[ Y e^{n e^{r(T-t)} Y} \right] \). Then, we have

**Lemma.** For any \( t \in [0, T) \), equation (13) has a unique positive root \( q_1 (t) \in (0, 1) \).
Proof. Let 
\[ g_1(q) = M'_Y \left( nqe^{r(T-t)} \right), \]
and 
\[ g_2(q) = \mu_1 + 2\Lambda (1 - q) \mu_2. \]
Then, we have 
\[ \begin{cases} 
  g_1(0) = \mu_1, \\
  g_1'(q) = E \left[ n e^{r(T-t)} Y^2 e^{nqe^{r(T-t)}} \right] > 0, \\
  g_1''(q) = E \left[ n^2 e^{2r(T-t)} Y^3 e^{nqe^{r(T-t)}} \right] > 0. \tag{14} 
\end{cases} \]

The meaning of the \((14)\) is that for any \(t \in [0, T)\), \(g_1(q)\) is an increasing convex function with \(g_1(0) = \mu_1\). Furthermore, \(g_2(q)\) is a decreasing linear function with \(g_2(0) = \mu_1 + 2\Lambda \mu_2\) and \(g_2(1) = \mu_1\). Since \(g_1(0) < g_2(0)\) and \(g_1(1) > g_2(0)\), there is a unique intersection between \(g_1(q)\) and \(g_2(q)\) at some \(0 < q_1(t) < 1\), and hence the proof is complete.

From Lemma, we can obtain \(q_1(t)\). For any \(0 \leq t_1 \leq t_2 \leq T\), we have 
\[ E \left[ Y \exp \left( nqe^{r(T-t_2)} Y \right) \right] > E \left[ Y \exp \left( nqe^{r(T-t_1)} Y \right) \right], \]
and know \(q_1(0) < q_1(T)\) from Lemma.

Under the net profit condition with the retention level \(q_1(t) \in [\bar{q}, 1]\) and \(\bar{q} = 1 - \sqrt{\frac{T}{\Lambda}}\), three cases can be concluded as the optimal reinsurance policy based on the different values of net profits, as

(I) If \(\bar{q} \leq q_1(0)\), when \(t = 0\), the result of the optimal reinsurance strategy is not lower than the net profit condition threshold. Under this condition, since the insurance company can achieve excess benefits, they will adopt the optimal strategy and ignore the net profit condition, in this case net profit conditions are negligible, therefore the optimal reinsurance policy is 
\[ q^*(t) = q_1(t). \]

(II) If \(\bar{q} \geq q_1(T)\), the optimal reinsurance policy is 
\[ q^*(t) = \bar{q}. \]

(III) If \(q_1(0) < \bar{q} < q_1(T)\) by using the Lemma, we see that there exists \(\bar{t} \in (0, T)\) which satisfies \(q_1(\bar{t}) = \bar{q}\). So the optimal reinsurance policy is 
\[ q^*(t) = \begin{cases} 
  \bar{q}, & t \in [0, \bar{t}], \\
  q_1(t), & t \in (\bar{t}, T]. 
\end{cases} \]

Remark 1. Case (II) is almost impossible in actual trading, so we just analyze this situation in the theoretical aspect.

Put \((A, q) = (A^*, q^*)\) in \((11)\). Then, after some algebraic simplification, it can be shown that \((8)\) is a solution to \((11)\) if \(G(t, a)\) is a solution to 
\[ \begin{align*}
  G_t - mn e^{r(T-t)} - \lambda + \alpha (\bar{a} - a) G_a + \frac{1}{2} \beta_2^2 \left[ G_a^2 + G_{aa} \right] \\
  + \frac{1}{2} n^2 e^{2r(T-t)} a^2 + \frac{(a + c - \theta - r)}{\sigma} + \sigma \beta \rho G_a \gamma \rho_1 n e^{r(T-t)} \\
  - \frac{1}{2} \frac{(a + c - \theta - r)}{\sigma^2} - \frac{1}{2} \left[ \gamma \rho_1 n e^{r(T-t)} \right]^2 + f_2(q^*(t), t) = 0, \tag{15}
\end{align*} \]
with the boundary condition of $G(T, a) = 0$.

Similar to the result of Rishel [26], we have the following theorem.

**Theorem 3.2.** The PDE (15) with the terminal condition (9) has a solution with the form

$$G(t, a) = K(t)a^2 + J(t)a + L(t),$$

if $K(t)$ is a solution to

$$K'(t) - 2 \left( \alpha + \frac{\beta \rho_2}{\sigma} \right) K(t) + 2 \beta^2 (1 - \rho_2^2) K^2(t) - \frac{1}{2\sigma^2} = 0,$$

with the terminal condition

$$K(t) = 0,$$

defined on $[0, T]$; $J(t)$ is a solution to

$$J'(t) + \left[ 2 \beta^2 (1 - \rho_2^2) K(t) - \alpha - \frac{\beta \rho_2}{\sigma} \right] J(t) - \frac{(c - \theta - r) (1 + 2\sigma \beta \rho_2)}{\sigma^2} - \gamma \rho_1 n e^{r(T-t)} - 2a_a K(t) = 0,$$

with the terminal condition

$$J(T) = 0,$$

and $L(t)$ is a solution to

$$L'(t) + N(t) + \left[ a + \beta \rho_2 \gamma \rho_1 n e^{r(T-t)} - \frac{(c - \theta - r) \sigma \beta \rho_2}{\sigma^2} \right] J(t) + \frac{1}{2} \beta^2 (1 - \rho_2^2) J^2(t) + \left[ \beta^2 + 2 \beta \rho_2 \gamma \rho_1 n e^{r(T-t)} \right] K(t) = 0,$$

with the terminal condition

$$L(T) = 0,$$

where

$$N(t) = -n m e^{r(T-t)} - \lambda + \frac{1}{2} \left[ \gamma e^{r(T-t)} \right]^2 - \frac{(c - \theta - r)^2}{2\sigma^2} + \frac{(c - \theta - r) \gamma \rho_1 n e^{r(T-t)}}{\sigma} - \frac{1}{2} \left[ \gamma \rho_1 n e^{r(T-t)} \right]^2 + f_2(q^*(t), t).$$

Note that $K'$, $J'$, and $L'$ are the derivatives of $K$, $J$, and $L$, respectively.

**Proof.** Substituting (16) into the PDE (15) gives

$$K'(t)a^2 + J'(t)a + L'(t) + b(t) n m e^{r(T-t)} - \lambda + \alpha (a - a) [2K(t)a + J(t)]$$

$$+ \frac{1}{2} \beta^2 \left[ 2K(t)a + J(t) \right] + \frac{1}{2} a^2 \gamma^2 e^{2r(T-t)} - \frac{1}{2} \left[ \gamma \rho_1 n e^{r(T-t)} \right]^2$$

$$+ a + (c - \theta - r + \sigma \beta \rho_2 [2K(t)a + J(t)]) \gamma \rho_1 n e^{r(T-t)}$$

$$- \frac{\{a + (c - \theta - r + \sigma \beta \rho_2 [2K(t)a + J(t)]) \}^2}{2\sigma^2} + f_2(q^*(t), t) = 0.$$

Multiplying out terms in (23) gives
\[K'(t)a^2 + J'(t)a + L'(t) + (bv - m)ne^{r(T - t)} - \lambda + 2\alpha(a - a)K(t)a + \alpha(a - a)J(t) + \frac{1}{2}2\beta^2[4K^2(t)a^2 + 4K(t)J(t)a + J^2(t) + 2K(t)] + \frac{1}{2}n^2\gamma e^{2r(T - t)} + \frac{1}{\sigma}\gamma^n ne^{r(T - t)}a + \frac{\sigma\beta\rho_2}{\sigma}2K(t)\gamma^n ne^{r(T - t)} + \frac{c - \theta - r}{\sigma}\gamma^n ne^{r(T - t)} + \frac{\sigma\beta\rho_2}{\sigma}J(t)\gamma^n ne^{r(T - t)} - \frac{1}{2}[\gamma^n ne^{r(T - t)}]^2 - \frac{[2\sigma\beta\rho_2K(t) + 1]^2a^2}{2\sigma^2} - \frac{1}{2}\beta^2\rho_2J^2(t) - \frac{1}{\sigma}\beta\rho_2J(t)a - 2\beta\rho_2J(t)\beta\rho_2J(t)a - \frac{(c - \theta - r)^2}{2\sigma^2} - \frac{(c - \theta - r)[1 + 2\sigma\beta\rho_2K(t)]}{\sigma^2} - \frac{(c - \theta - r)\beta\rho_2J(t)}{\sigma^2} + f_2(\theta^n(t), t) = 0.

Grouping terms according to the powers of \(a\) leads to

\[
\left[ K'(t) - 2\left(\alpha + \frac{\beta\rho_2}{\sigma}\right)K(t) + 2\beta^2(1 - \rho_2^2)K^2(t) - \frac{1}{2\sigma^2}\right]a^2
+ \left[ J'(t) + 2\beta^2(1 - \rho_2^2)K(t) - \alpha - \frac{\beta\rho_2}{\sigma}\right]J(t)
- \left[\frac{(c - \theta - r)(1 + 2\beta\rho_2K(t))}{\sigma^2} - \frac{\gamma^n ne^{r(T - t)}}{\sigma} - 2\bar{a}\alpha K(t)\right]a
+ \left[\bar{a}\alpha + \beta\rho_2\gamma^n ne^{r(T - t)} - \frac{(c - \theta - r)\sigma\beta\rho_2}{\sigma^2}\right]J(t)
+ L'(t) + N(t) + \frac{1}{2}\beta^2(1 - \rho_2^2)J^2(t) + \left[\beta^2 + 2\beta\rho_2\gamma^n ne^{r(T - t)}\right]K(t) = 0.
\]

where

\[N(t) = -mne^{r(T - t)} - \lambda + \frac{1}{2}\gamma^2 e^{r(T - t)} - \frac{(c - \theta - r)^2}{2\sigma^2} - \frac{(c - \theta - r)\gamma^n ne^{r(T - t)}}{\sigma^2} - \frac{1}{2}[\gamma^n ne^{r(T - t)}]^2 + f_2(\theta^n(t), t).
\]

Thus, (16) is a solution of the PDE (15) if \(K(t), J(t), L(t)\) are solutions to the differential equations (17), (19) and (21), respectively. The boundary condition (9) implies (18), (20) and (22). Hence, the proof is complete. \(\square\)

Theorem 3.2. gives a solution to the PDE (15) with the boundary condition (9), only if the ordinary differential equations (17), (19), (21) with respective boundary conditions (18), (20), (22) have solutions on \(0, T\). Notice that if (17) with (18) has a solution for \(K(t)\) on \(0, T\), then (19) with (20) and (21) with (22) have solutions on \(0, T\) for \(J(t)\) and \(L(t)\), respectively, since (19) and (21) are linear differential equations and their solutions are just integrals. So we mainly discuss the solutions to the Riccati equation for \(K(t)\). For notational convenience, letting

\[D = 2\beta^2(1 - \rho_2^2), \quad B = -2\left(\alpha + \frac{\beta\rho_2}{\sigma}\right), \quad C = -\frac{1}{2\sigma^2}.
\]
Then, equation (17) becomes
\[ K'(t) + DK^2(t) + BK(t) + C = 0, \tag{24} \]
which is a normal Riccati equation with condition
\[ B^2 - 4DC > 0. \]
Using standard methods, we obtain the following solution to the Riccati equation (24) with the boundary condition \( K(T) = 0 \):
\[ K(t) = C_1 + \frac{e^{t\sqrt{B^2 - 4DC}}}{\sqrt{B^2 - 4DC}} \left( e^{t\sqrt{B^2 - 4DC}} - e^{T\sqrt{B^2 - 4DC}} \right) - \frac{1}{C_1} e^{T\sqrt{B^2 - 4DC}}, \tag{25} \]
where
\[ C_1 = \frac{-B - \sqrt{B^2 - 4DC}}{2D}. \]
Based on (25), one can show that the solution to the linear ordinary differential equation (19) with the boundary condition (20) has the form
\[ J(t) = e^{\int_t^T p(s) ds} \left[ - \int_t^T q(s) e^{-\int_t^s p(u) du} ds \right], \tag{26} \]
where
\[ p(s) = 2\beta^2 (1 - \rho_2^2) K(s) - \alpha - \frac{\beta \rho_2}{\sigma}, \]
and
\[ q(s) = \frac{(c - \theta - r) (1 + 2\sigma \beta \rho_2)}{\sigma^2} - \frac{\gamma \rho_1 n e^{r(T-t)}}{\sigma} - 2\alpha K(s). \]
Moreover, from (21), (25) and (26), integration yields
\[
L(t) = - \int_t^T \left\{ N(s) + \left[ \tilde{a} \alpha + \beta \rho_2 \gamma \rho_1 n e^{r(T-s)} - \frac{(c - \theta - r) \sigma \beta \rho_2}{\sigma^2} \right] J(s) \right. \\
\left. + \frac{1}{2} \beta^2 (1 - \rho_2^2) J^2(s) + \left[ \beta^2 + 2\beta \rho_2 \gamma \rho_1 n e^{r(T-s)} \right] K(s) \right\} ds \\
= - n \left\{ \frac{\alpha}{r} + \frac{(c - \theta - r) \gamma \rho_1}{\sigma} \right\} e^{r(T-t)} - 1 - \int_t^T f_2(q^*(s), s) ds \\
+ \left[ \lambda + \frac{(c - \theta - r)^2}{2\sigma^2} \right] (T - t) - \frac{1}{4} \gamma^2 n^2 \left[ \frac{1}{r} - \rho_1^2 \right] e^{2r(T-t)} - 1 \\
- \int_t^T \left\{ \tilde{a} \alpha + \beta \rho_2 \gamma \rho_1 n e^{r(T-s)} - \frac{(c - \theta - r) \sigma \beta \rho_2}{\sigma^2} \right\} J(s) \\
+ \frac{1}{2} \beta^2 (1 - \rho_2^2) J^2(s) + \left[ \beta^2 + 2\beta \rho_2 \gamma \rho_1 n e^{r(T-s)} \right] K(s) \right\} ds.
\]
Assume that the investor has an exponential utility function

Letting

\[ L_1(t) = -n \left[ -\frac{c}{r} + \frac{(c - \theta - r) \gamma \rho_1}{\sigma} e^{r(T-t)} - 1 \right] + \left[ \lambda + \frac{(c - \theta - r)^2}{2\sigma^2} \right] (T-t) - \gamma^2 n^2 \left[ \frac{1}{r} - \frac{1}{4} \gamma \rho_1^2 \right] e^{2r(T-t)} - 1 \]

\begin{align*}
&\quad - \int_t^T \left\{ \bar{\alpha} \gamma \rho_1 n \ln(T-s) - \frac{(c - \theta - r) \sigma \beta \rho_2}{\sigma^2} \right\} J(s) \\
&\quad + \frac{1}{2} \beta^2 (1 - \rho_2^2) J^2(s) + \left[ \beta^2 + 2 \beta \rho_2 \gamma n \ln(T-s) \right] K(s) \right\} ds.
\end{align*}

(27)

Parallel to Cases (I)-(III) discussed earlier, we get

\[ L(t) = \begin{cases} 
L_1(t) - \int_t^T f_2(q^*(s), s) ds, & \text{if } \bar{q} \leq q_1(0), \\
L_1(t) - \int_t^T f_2(\bar{q}, s) ds, & \text{if } \bar{q} \geq q_1(T),
\end{cases} \]

and if \( q_1(0) < \bar{q} < q_1(T) \),

\[ L(t) = \begin{cases} 
L_1(t) - \int_t^T f_2(\bar{q}, s) ds + k, & \text{if } t \in [0, \bar{t}], \\
L_1(t) - \int_t^T f_2(q^*(s), s) ds, & \text{if } t \in (\bar{t}, T],
\end{cases} \]

where \( f_2(q, t) \) is determined by (12), \( q^*(t) \) is determined by Cases (I)-(III), \( \bar{t} \) is given by equation \( q^*(\bar{t}) = \bar{q} \). The constant \( k = \int_{\bar{t}}^T f_2(\bar{q}, s) ds - \int_{\bar{t}}^T f_2(q^*(s), s) ds \), so \( L(t) \) is continuous differential function for all \( t \in [0, T] \).

To end the section, we summarize the result in the following theorem.

**Theorem 3.3.** Assume that the investor has an exponential utility function

\[ U(v) = \lambda_1 - \frac{\xi}{n} e^{-nv}, \]

and \( q_1(t) \) is a unique positive root to equation (13) for any \( t \in [0, T] \). Then, the optimal strategy for the optimization problem (3) subject to (4) is

\[ A^*(t) = \frac{[a(t) + c - \theta - r] + \sigma \beta \rho_2 [2K(t) a(t) + J(t) a(t)]}{\sigma^2 n e^{r(T-t)}} - \frac{\gamma \rho_1}{\sigma}, \]

for any \( t \in [0, T] \). Furthermore,

(I) For any \( t \in [0, T] \), if \( \bar{q} \leq q_1(0) \), the optimal reinsurance strategy \( q^*(t) = q_1(t) \), and the corresponding value function has the form

\[ H(t, v, a) = \lambda_1 - \frac{\eta}{n} \exp \left[ -n v e^{r(T-t)} + G_1(t, a) \right], \]

where

\[ G_1(t, a) = K(t) a^2 + J(t) a + L_1(t) - \int_t^T f_2(q^*(s), s) ds. \]

(II) For any \( t \in [0, T] \), if \( \bar{q} \geq q_1(T) \), the optimal reinsurance strategy \( q^*(t) = \bar{q} \), and the corresponding value function has the form

\[ H(t, v, a) = \lambda_1 - \frac{\eta}{n} \exp \left[ -n v e^{r(T-t)} + G_2(t, a) \right], \]

where

\[ G_2(t, a) = K(t) a^2 + J(t) a + L_1(t) - \int_t^T f_2(\bar{q}, s) ds. \]
For any $t \in [0, T]$, if $q_1 (0) < \bar{q} < q_1 (T)$, the optimal reinsurance strategy

$$q^* (t) = \begin{cases} \bar{q}, & t \in (0, \bar{t}), \\ q_1 (t), & t \in (\bar{t}, T] \end{cases}$$

and the corresponding value function has the form

$$H (t, v, a) = \begin{cases} \lambda_1 - \frac{2}{a} \exp \left[ -nve^{r(T-t)} + G_3 (t, a) \right], & t \in [0, \bar{t}], \\ \lambda_1 - \frac{2}{a} \exp \left[ -nve^{r(T-t)} + G_1 (t, a) \right], & t \in (\bar{t}, T], \\ \end{cases}$$

where

$$G_3 (t, a) = K(t)a^2 + J(t)a + L_1 (t) - \int_{t}^{T} f_2 (\bar{q}, s) ds + k,$$

$f_2, q_1 (t), K(t), J(t)$ and $L_1 (t)$ are given in (12), (13), (25), (26) and (27) respectively.

**Remark 2.** In this paper, because of the choice of exponential utility, the optimal strategies do not depend on wealth, but on time to maturity $T$ and $a(t)$. If other utility functions are selected, this will not be the case.

**Remark 3.** The results in Theorem 3.3 show that the investment strategy and the value function are all affected by the above parameters. Specifically, the higher the dividend income is, the greater the number of risk assets will be invested. Conversely, the higher the transaction costs and risk-free returns are, the less the number of risk assets will be invested.

4. **Numerical Examples for the Optimal Reinsurance Policy.** In this section, we present two numerical examples, to illustrate the results we obtained in previous sections. Suppose that claim size $\{Y_i\}$ are uniform distributed in the interval $[0, 2]$, denoted by $Y_i \sim U [0, 2]$, then we have $\mu_1 = 1, \mu_2 = \frac{1}{2}$, and

$$M_Y \left( mve^{r(T-t)} \right) = \exp \left\{ \frac{2mve^{r(T-t)}}{2[mve^{r(T-t)}]^2} \right\} \left[ \frac{2mve^{r(T-t)}}{2[mve^{r(T-t)}]^2} \right] - 1 + 1.$$ (28)

Putting equation (28) back into equation (13) yields

$$\mu_1 + 2\Lambda (1 - q) \lambda \mu_2 = \frac{3 \exp \left\{ \frac{2mve^{r(T-t)}}{2[mve^{r(T-t)}]^2} \right\} \left[ \frac{2mve^{r(T-t)}}{2[mve^{r(T-t)}]^2} \right] - 1 + 1}{2[mve^{r(T-t)}]^2}.$$ (29)

**Example 1.** *(Reinsurance proportion under different levels of risk aversion)* In this example, we assume that $\lambda = 1, m = 2, \Lambda = 1, T = 10$ and $r = 0.3$. The result is shown in Figure 1.

A simple calculation shows that $\theta = (m - \lambda \mu_1) / \lambda \mu_2 = \frac{3}{4}$, and $\bar{q} = 1 - \sqrt{\frac{2}{3}} \approx 0.134$. So equation (29) becomes

$$1 + \frac{8}{3} \left( 1 - q (t) \right) = \frac{\exp \left\{ q (t) e^{0.3(T-t)} \right\} \left[ q (t) e^{0.3(T-t)} \right] - 1 + 1}{2[q (t) e^{0.3(T-t)}]^2}.$$ (1)

1. When $n = 0.2$, from Figures 1 we notice that $\bar{q} < q_1 (0)$, in this case, the net profit condition becomes trivial, thus the optimal reinsurance policy is

$$q^* (t) = q_1 (t).$$
When \( n = 0.5 \), we can see \( \bar{q} > q_1(0) \) from Figures 1, in this case, we need calculating \( \bar{t} \), that is

\[
1 + \frac{8}{3} (1 - 0.134) = \frac{\exp\left\{0.134e^{0.3(10-t)}\right\} \left[0.134e^{0.3(10-t)} - 1\right] + 1}{2[0.067e^{0.3(10-t)}]^2},
\]

because \( \bar{t} \) is positive, we obtain \( \bar{t} = 1.559 \). So the optimal reinsurance policy is

\[
q^*(t) = \begin{cases} 
0.134, & t \in [0, 1.559], \\
q_1(t), & t \in (1.559, 10].
\end{cases}
\]

When \( n = 1 \), similar to case (2), we obtain \( \bar{t} = 3.870 \). So the optimal reinsurance policy is

\[
q^*(t) = \begin{cases} 
0.134, & t \in [0, 3.870], \\
q_1(t), & t \in (3.870, 10].
\end{cases}
\]

Figure 1 shows that the optimal reinsurance strategy \( q^* \) decrease w.r.t. the CARA parameter \( n \). It is well-known that larger \( n \) means that the insurer is more risk averse. Hence, if the insurer is more risk averse, she would like to purchase reinsurance to cede part of their losses to reinsurance.

**Example 2.** *(Reinsurance proportion under different safety loadings)* For \( \lambda = 1, m = 2, n = 0.5, T = 10 \) and \( r = 0.3 \), the optimal result is displayed in Figure 2.

A simple calculation shows that \( \theta = (m - \lambda \mu_1) / \lambda \mu_2 = 3/4 \), and equation (13) becomes

\[
1 + \frac{8}{3} \Lambda (1 - q(t)) = \frac{\exp\left\{q(t)e^{0.3(10-t)}\right\} \left[q(t)e^{0.3(10-t)} - 1\right] + 1}{2[0.5q(t)e^{0.3(10-t)}]^2}.
\]

Similar to example 1, when \( \Lambda = 1, 1.2, 1.5 \), putting them into \( 1 - \sqrt{\frac{\theta}{\Lambda}} \), we obtain \( \bar{q} = 0.1340, 0.2094, 0.2929 \), respectively. From Figures 2 we notice that \( \bar{q} < q_1(0) \) in these three cases. So in this example, the net profit condition becomes trivial, thus their the optimal reinsurance policies are

\[
q^*(t) = q_1(t).
\]

In Figure 2, we can also see that, a larger value of \( \Lambda \) will yield a higher retention level of optimal reinsurance. This simply states that as the price of reinsurance increases, the insurer should retain a greater share of each claim.

**Remark 4.** From Figures 1 and 2, we find that the optimal reinsurance strategy increases when the value of \( t \) increases, which means that the larger value of \( t \) is, the larger insurers share in the risk will be. Moreover, with the increase of \( \Lambda \), the insurer would take more insurance business risk, and so the insurer should raise the retention level of reinsurance to decrease the expensive payment to reinsurance.

5. **Conclusion.** To solve the problem of optimizing the investment and reinsurance strategy under different operation states of insurance company, this paper designs a new actuarial strategy selection model from the perspective of net profits to provide differentiated investment and reinsurance schemes. Specifically, we use mean reverting O-U process to show the trend of price, which describes the conversion of bull and bear market. Additionally, according to the standard of net profit, we set the threshold to simulate the operation state of enterprises by applying segmental
Figure 1. The optimal proportional level $q^*(t)$ with $n = 0.2$, $n = 0.5$, $n = 1$, respectively

Figure 2. The optimal proportional level $q^*(t)$ with $\Lambda = 1$, $\Lambda = 1.2$, $\Lambda = 1.5$, respectively
function; and further account for the influence of stock income and cost on the return of investment and reinsurance. Using the method of stochastic optimal control and HJB equation, the numerical results of this paper reveal that the proposed model can maximize the expected exponential utility of terminal wealth. Meanwhile, based on the net profit, the sectional investment strategy can also effectively reduce the lagging risk of investment strategy adjustment caused by the change of insurance company’s operating state. Therefore, in the actual trading, insurance companies can maximize the long-term return of investment and reinsurance, while reduce the operational risk in investing by using our proposed scheme. However, this paper is not without limitation. Due to the difficulty in solving the explicit solution, the proposed model fails to obtain the optimal proportion of investment and reinsurance when considering the ruin probability. In future research, it would be interesting to extend our model by relaxing these assumptions and considering more general cases. Additionally, based on the basis of stochastic interest rate and stochastic volatility mode, we will further increase the discussion of setting the optimal investment and reinsurance strategies under the condition of ruin probability.

Acknowledgments. This work was supported by the National Natural Science Foundation of China (Grants No. 71971096), the Fundamental Research Funds for the Central Universities (Grant No. 31610529) and the Ministry of Education of Humanities and Social Science Project (Grant No. 20YJC630123).

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