The First Passage Time Problem for Mixed-Exponential Jump Processes with Applications in Insurance and Finance

Chuancun Yin, Yuzhen Wen, Zhaojun Zong, and Ying Shen

School of Mathematical Sciences, Qufu Normal University, Shandong 273165, China

Correspondence should be addressed to Chuancun Yin; ccyin@mail.qfnu.edu.cn

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1. Introduction

One-sided and two-sided exit problems for the compound Poisson processes and jump diffusion processes with two-sided jumps have been applied widely in a variety of fields. For example, in the theory of actuarial mathematics, the problem of first exit from a half-line is of fundamental interest with regard to the classical ruin problem and the expected discounted penalty function or the Gerber-Shiu function as well as the expected total discounted dividends up to ruin. See, for example, Klüppelberg et al. [1], Mordecki [2], Xing et al. [3], Cai et al. [4], Zhang et al. [5], Chi [6], and Chi and Lin [7]. In the setting of mathematical finance, the first passage time plays a crucial role for the pricing of many path-dependent options and American-type and Russian-type options; see, for example, Kou [8], Kou and Wang [9, 10], Asmussen et al. [11], Levendorskii [12], Alili and Kyprianou [13], Cai et al. [14], and Cai and Kou [15], as well as certain credit risk models; see, for example, Hilberink and Rogers [16], Le Courtois and Quittard-Pinon [17], and Dong et al. [18]. Many optimal stopping strategies also turn out to boil down to the first passage problem for jump diffusion processes; see, for example, Mordecki [19]. In queueing theory one-sided and two-sided first-exit problems for the compound Poisson processes and jump diffusion processes with two-sided jumps have been playing a central role in a single-server queueing system with random workload removal; see, for example, Perry et al. [20]. Usually, when we study the first passage problem, the models with two-sided jumps are more difficult to handle than those with one-sided jumps, because the undershoot and overshoot problem could not be avoided. Despite the maturity of this field of study, it is surprising to note that, until very recently, it can only be solved for certain kinds of jump distributions, such as the Kou’s double exponential jump diffusion model (see Kou [8] and Kou and Wang [9]). Recently, Cai and Kou [15] proposed a mixed-exponential jump diffusion process to model the asset return and found an expression for the joint distribution of the first passage time and the overshoot for a mixed-exponential jump diffusion process. In the most recent paper of Wen and Yin [21], two-sided first-exit problem for a jump process having jumps with rational Laplace transform was studied. However, determination of the coefficients in expressions of the above two papers still remains a mathematical and computational challenge. In this paper, we will further study the first passage problems in Cai and Kou [15] and give an explicit expression for the joint distribution of the first passage time and the overshoot for a mixed-exponential jump process with or without a diffusion. Moreover, we present several applications in insurance risk theory and in finance.

The rest of the paper is organized as follows. In Section 2, the model assumptions are formulated. In Section 3, we study
the one-sided passage problem from below or above for compound Poisson process and jump diffusion process. In Section 4, we give explicit expression of the Gerber-Shiu function with two-sided jumps. In Section 5, we present the analytical solutions to the pricing problem of one barrier function with two-sided jumps. In this subsection we assume that the downward jumps have an arbitrary distribution with density \( f_\downarrow \) and Laplace transform \( \hat{f}_\downarrow \), while the upward jumps are mixed-exponential; that is,

\[
f_\downarrow (y) = p f_{\downarrow} (−y) \mathbf{1}_{y < 0} + q \sum_{i=1}^{m} p_i \eta_i e^{-\eta_i y} \mathbf{1}_{y \geq 0},
\]

where constants \( p, q \geq 0 \), \( p + q = 1 \), \( 0 < \eta_1 < \eta_2 < \cdots < \eta_m < \infty \), and \( \sum_{i=1}^{m} \rho_i = 1 \).

The Lévy exponent of \( X \) is given by

\[
\psi_1(z) = \frac{1}{2} \sigma^2 z^2 + \mu z + \lambda \left( q \sum_{i=1}^{m} \rho_i \eta_i - z + p \hat{f}_{\downarrow}(-z) - 1 \right).
\]

Using the same argument as in Cai and Kou [15] we have the following.

**Lemma.** (i) For sufficiently large \( \alpha > 0 \), if \( |\sigma| > 0 \) or \( \mu > 0 \) and \( \sigma = 0 \), then the equation \( \psi_1(z) = \alpha \) has exactly \( m + 1 \) distinct positive roots \( \beta_1, \ldots, \beta_{m+1} \) satisfying

\[
0 < \beta_1 < \beta_2 < \cdots < \beta_{m+1} < \infty.
\]

(ii) If \( \mu \leq 0 \) and \( \sigma = 0 \), then the equation \( \psi_1(z) = \alpha \) has exactly \( m \) distinct positive roots \( \beta_1, \ldots, \beta_m \) satisfying

\[
0 < \beta_1 < \beta_2 < \cdots < \beta_m < \infty.
\]

Cai and Kou [15] found the joint distribution of the first passage time \( \tau_{\downarrow H}^* \) and \( X(\tau_{\downarrow H}^*) \) in case \( \alpha > 0 \) under the additional assumption \( f_\downarrow(y) \) is also mixed-exponential. However, for a general \( f_\downarrow(y) \) in case the upward jumps are mixed-exponential (cf. Yin et al. [25]), for any sufficiently large \( \alpha > 0 \), \( \theta < \eta_1 \), and \( x < H \), we have

\[
E_x \left( e^{-\alpha \tau_{\downarrow H}^* \mathbf{1}_{X(\tau_{\downarrow H}^*)}} \right) = \sum_{k=1}^{m+1} w_k e^{\beta_k x},
\]
where \( w := (w_1, \ldots, w_{m+1})' \) is a vector uniquely determined by the following system \( A \bar{B} w = J \), where \( A \) is an \((m+1) \times (m+1)\) matrix

\[
A = \begin{bmatrix}
1 & 1 & \cdots & 1 \\
\eta_1 & \eta_1 & \cdots & \eta_1 \\
\eta_1 - \beta_1 & \eta_1 - \beta_2 & \cdots & \eta_1 - \beta_{m+1} \\
\vdots & \vdots & \ddots & \vdots \\
\eta_m & \eta_m & \cdots & \eta_m \\
\eta_m - \beta_1 & \eta_m - \beta_2 & \cdots & \eta_m - \beta_{m+1}
\end{bmatrix},
\]

(10)

\( B \) is an \((m+1) \times (m+1)\) diagonal matrix, and \( f \) is an \((m+1)\)-dimensional vector

\[
B = \text{Diag} \left[ e^{\beta_1 H}, \ldots, e^{\beta_{m+1} H} \right],
\]

(11)

\[
J = e^{\beta H} \left( 1, \frac{\eta_1}{\eta_1 - \theta}, \ldots, \frac{\eta_m}{\eta_m - \theta} \right)'.
\]

In this paper we will determine the coefficients \( w_i \)'s explicitly. Moreover, we also consider the cases \( \mu > 0, \sigma = 0 \) and \( \mu \leq 0, \sigma = 0 \).

**Theorem 2.** For any sufficiently large \( \alpha > 0 \), one has,

(i) for \( \theta < \eta_1 \) and \( x < H \),

\[
E_x \left( e^{-\alpha r_i \theta x(\ell_0)} \right)_{[r_i' < \infty]} = e^{\beta H} \sum_{k=1}^{N} \prod_{i=1, i \neq k}^{N} (1 - \theta/\eta_i) \right) e^{-\beta_k (H - x)},
\]

(12)

(ii) for \( y \geq 0, x < H \),

\[
E_x \left( e^{-\alpha r_i \theta} 1_{[X(\ell_0) = H - x]} \right) = \sum_{k=1}^{N} B_k \left( A_{k0} \delta_0 (y) + \sum_{l=1}^{m} A_{kl} \eta_l e^{-\gamma_l y} \right) e^{-\beta_k (H - x)} dy,
\]

(13)

(iii) for \( x < H \),

\[
E_x \left( e^{-\alpha r_i \theta} 1_{[X(\ell_0) = H]} \right) = \sum_{k=1}^{N} B_k A_{k0} e^{-\beta_k (H - x)},
\]

(14)

(iv) for \( x < H, y \geq 0 \),

\[
E_x \left( e^{-\alpha r_i \theta} 1_{[X(\ell_0) = H - x]} \right) = \sum_{k=1}^{N} B_k \left( \sum_{l=1}^{m} A_{kl} \eta_l e^{-\gamma_l y} \right) e^{-\beta_k (H - x)},
\]

(15)

(v) for \( x < H \),

\[
E_x \left( e^{-\alpha r_i \theta} \right)' = \sum_{k=1}^{N} B_k e^{-\beta_k (H - x)},
\]

(16)

where \( \beta_1, \ldots, \beta_N \) are the positive roots of the equation \( \psi_1 (\beta) = \alpha, \delta_0 (x) \) is the Dirac delta at \( x = 0 \), and

\[
N = \begin{bmatrix}
m + 1, & \text{if } \sigma > 0, \text{ or } \sigma = 0, \mu > 0, \\
m, & \text{if } \sigma = 0, \mu \leq 0,
\end{bmatrix}
\]

\[
B_j = \frac{\prod_{k=1}^{m} (1 - \beta_j/\eta_k)}{\prod_{k=1}^{m} (1 - \beta_j/\beta_k)}, \quad j = 1, \ldots, N,
\]

(17)

\[
A_{kl} = \frac{\prod_{i=1, i \neq k}^{N} \eta_i}{\prod_{i=1}^{m} \eta_i}, \quad \text{if } \sigma > 0, \text{ or } \sigma = 0, \mu > 0,
\]

(18)

\[
A_{kl} = \frac{\prod_{i=1, i \neq k}^{N} (1 - \eta_l/\beta_i)}{\prod_{i=1}^{m} (1 - \eta_l/\eta_i)}, \quad l = 1, 2, \ldots, m.
\]

**Proof.** We prove the result for the case \( \sigma > 0 \) only; the rest of the cases can be proved similarly. To prove Theorem 2, the most difficult part is to find the inverse of matrix \( A \). For simplicity, we write

\[
A = \begin{bmatrix}
A_{11} & A_{12} \\
A_{21} & A_{22}
\end{bmatrix},
\]

(18)

where

\[
A_{11} = (1), \quad A_{12} = (1, \ldots, 1)_{1 \times m},
\]

\[
A_{21} = \left( \frac{\eta_1}{\eta_1 - \beta_1}, \ldots, \frac{\eta_m}{\eta_m - \beta_1} \right)',
\]

(19)

\[
A_{22} = \begin{bmatrix}
\eta_1 & \cdots & \eta_1 - \beta_{m+1} \\
\eta_1 - \beta_2 & \cdots & \eta_2 - \beta_{m+1} \\
\vdots & \ddots & \vdots \\
\eta_m & \cdots & \eta_m - \beta_{m+1}
\end{bmatrix}
\]

Note that \( A_{22} \) can be written as \( A_{22} = J_1 C_1 \), where \( J_1 = \text{Diag}(\eta_1, \ldots, \eta_m) \) is a diagonal matrix, \( C_1 = \{1/(\eta_l - \beta_{l+1})\}_{1 \leq l \leq m} \) is a Cauchy matrix of order \( m \) which is invertible, and the inverse is given by \( C_1^{-1} = [d_{ij}]_{m \times m} \), where

\[
d_{ij} = \frac{A_1 (\beta_{i+1})}{A_1 (\eta_1)} \frac{B_i (\eta_j)}{B_i (\beta_{i+1}) (\eta_j - \beta_{i+1})},
\]

(20)

Here,

\[
A_1 (x) = \prod_{j=1}^{m} (x - \eta_j), \quad B_1 (x) = \prod_{j=1}^{m} (x - \beta_{j+1}).
\]

(21)
Then the inverse of $A_{22}$ is given by

$$
A_{22}^{-1} = \begin{bmatrix}
\frac{1}{\eta_1} d_{11} & \cdots & \frac{1}{\eta_m} d_{1m} \\
\frac{1}{\eta_1} d_{21} & \cdots & \frac{1}{\eta_m} d_{2m} \\
\vdots & \ddots & \vdots \\
\frac{1}{\eta_1} d_{m1} & \cdots & \frac{1}{\eta_m} d_{mm} 
\end{bmatrix}.
$$

(22)

The determinant of $C_1$ is given by (see Calvetti and Reichel [26])

$$
det(C_1) = \prod_{1 \leq i < j \leq m} \left( \frac{\eta_i - \eta_j}{\eta_i - \beta_{j+1}} \right) \prod_{i=1}^m \left( \eta_i - \beta_1 \right).
$$

(23)

After some algebra,

$$
\frac{A}{A_{22}} = \frac{A_{22}^{-1}}{(A_{22}^{-1})} = \begin{bmatrix}
\frac{1}{\eta_1} & \cdots & \frac{1}{\eta_m} \\
\frac{1}{\eta_1} & \cdots & \frac{1}{\eta_m} \\
\vdots & \ddots & \vdots \\
\frac{1}{\eta_1} & \cdots & \frac{1}{\eta_m} 
\end{bmatrix}.
$$

(24)

Now by solving $AB\omega = I$ we find that

$$
w = B^{-1}A^{-1}I
$$

$$
e^{\theta H} \left( B_1 \prod_{i=1}^{m+1} (1 - \theta/\beta_i) e^{-\beta_i H}, \ldots, B_m \prod_{i=1}^{m+1} (1 - \theta/\beta_i) e^{-\beta_i H} \right),
$$

(29)

from which and from (9) we get (12).

By the fractional expansion,

$$
\prod_{i=1}^{m+1} (1 - \theta/\beta_i) = A_{k0} + A_{k1} \frac{\eta_1}{\eta_1 - \theta} + \cdots + A_{km} \frac{\eta_m}{\eta_m - \theta},
$$

(30)

where the coefficients $A_{kj}$'s are defined in the theorem. Substituting (30) into (12) and inverting it on $\theta$ immediately lead to (13). Equations (14)–(16) are direct consequence of (13). This ends the proof of Theorem 2.

$\square$

Example 3. Let $m = 1$; several expressions are obtained by Theorem 2. When $\sigma > 0$ or $\sigma = 0$ and $\mu > 0$, for $x < H$, $\theta < \eta_1$, and $y \geq 0$, we recover the following three formulae which are obtained by Kou and Wang [10]:

$$
E_x \left( e^{-\sigma i\tau_1^x x H(\tau_1)} \right)
$$

$$
e^{\delta H} \left( (\beta_2 - \theta)(\eta_1 - \beta_1) e^{-\beta_1 x - \beta_2 (H-x)}, \ldots + (\beta_1 - \theta)(\beta_2 - \eta_1) e^{-\beta_2 (H-x)} \right),
$$

(31)

$$
E_x \left( e^{\delta \tau_1^x} \mathbb{1}_{x < H}(x < H) \right)
$$

$$
e^{-\eta_1 x}(\beta_2 - \eta_1)(\eta_1 - \beta_1) \eta_1 (\beta_2 - \beta_1) e^{-\beta_2 (H-x)} e^{-\beta_1 x},
$$

(32)

3.2. One-Sided Exit from below. In this subsection we assume that the upward jumps have an arbitrary distribution with
Laplace transform $\tilde{f}_+$, while the downward jumps are mixed-exponential; that is,

$$ f_Y(y) = pf_+(y) + q \sum_{j=1}^{m} p_j \eta_j e^{\eta_j y} 1_{y<0}, \quad (33) $$

where constants $p, q \geq 0$, $p + q = 1$, $0 < \eta_1 < \eta_2 < \cdots < \eta_m < \infty$, and $\sum_{j=1}^{m} p_j = 1$. By (3), the Lévy exponent of $X$ is given by

$$ \psi_\alpha(z) = \frac{1}{2} \sigma^2 z^2 + \mu z + \lambda \left( pf_+(-z) + q \sum_{j=1}^{m} p_j \eta_j + z - 1 \right). \quad (34) $$

By replacing $X$ by $-X$ in the previous section, we get the main finding in this section.

**Theorem 4.** For any sufficiently large $\alpha > 0$, one has,

(i) for $\theta > 0, x > h$,

$$ E_x \left( e^{-\alpha \tau_\alpha + \delta X(\tau_\alpha)} 1_{\tau_\alpha < \infty} \right) = e^{-\theta h} \sum_{k=1}^{J} B_k \prod_{l=1}^{m} \left( 1 + \theta/\eta_l \right) e^{-\tau(x-h)}, \quad (35) $$

(ii) for $x > h, y \geq 0$,

$$ E \left( e^{-\alpha \tau_\alpha} 1_{[h-X(\tau_\alpha)] < dy} \right) = \sum_{k=1}^{J} B_k \left( A_k \delta_0(y) + \sum_{l=1}^{m} A_{kl} \eta_l e^{-\eta_l y} \right) e^{-\tau(x-h)} dy, \quad (36) $$

(iii) for $x > h$,

$$ E_x \left( e^{-\alpha \tau_\alpha} 1_{X(\tau_\alpha) = h} \right) = \sum_{k=1}^{J} B_k A_k e^{-\tau(x-h)}, \quad (37) $$

(iv) for $x > h$,

$$ E_x \left( e^{-\alpha \tau_\alpha} 1_{X(\tau_\alpha) > h} \right) = \sum_{k=1}^{J} B_k \left( \sum_{l=1}^{m} A_{kl} \right) e^{-\tau(x-h)}, \quad (38) $$

(v) for $x > h$,

$$ E_x \left( e^{-\alpha \tau_\alpha} 1_{X(\tau_\alpha) < h} \right) = \sum_{k=1}^{J} B_k A_k e^{-\tau(x-h)}, \quad (39) $$

where $-r_1, \ldots, -r_J$ are the negative roots of the equation

$$ \psi_\alpha(r) = \alpha $$

and

$$ J = \begin{cases} m + 1, & \sigma > 0, \text{ or } \sigma = 0, \mu > 0, \\ m, & \sigma = 0, \mu \geq 0, \end{cases} $$

$$ B_j = \prod_{l=1}^{m} \left( 1 - r_j/\eta_l \right), \quad j = 1, \ldots, J, $$

$$ A_{kl} = \prod_{l=1}^{m} \eta_l, \quad \sigma > 0, \text{ or } \sigma = 0, \mu > 0, $$

$$ A_{kl} = \prod_{l=1}^{m} \left( 1 - \eta_l/\eta_l \right), \quad \sigma = 0, \mu \leq 0, $$

$$ A_{kl} = \prod_{l=1}^{m} \left( 1 - \eta_l/\eta_l \right), \quad l = 1, 2, \ldots, m. $$

**Remark 5.** The result (39) agrees with the result of Theorem 1.1 in Mordecki [2], where only the case of $\sigma > 0$ and $p_j \geq 0$ ($i = 1, \ldots, m$) is considered.

**Example 6.** Let $m = 1$ in Theorem 4. When $\sigma > 0$ or $\sigma = 0$ and $\mu < 0$, for $\theta < \eta_1$ and $y \geq 0$,

$$ E_x \left( e^{-\alpha \tau_\alpha + \delta X(\tau_\alpha)} \right) = e^{-\theta h} \left( \frac{r_1 + \theta}{\theta + \eta_1} \right) e^{-\tau_1(x-h)} $$

and

$$ E_x \left( e^{-\alpha \tau_\alpha} 1_{[h-X(\tau_\alpha)] < y} \right) = e^{-\eta_1 (r_1 - \eta_1)} \eta_1^{r_1 (r_2 - r_1)} e^{-\tau_1(x-h)}. $$

When $\sigma = 0$ and $\mu \geq 0$, then for $\theta < \eta_1$ and $y \geq 0$,

$$ E_x \left( e^{-\alpha \tau_\alpha + \delta X(\tau_\alpha)} \right) = e^{-\theta h} \frac{1}{\eta_1} e^{-\tau_1(x-h)}, $$

$$ E_x \left( e^{-\alpha \tau_\alpha} 1_{[h-X(\tau_\alpha)] < y} \right) = e^{-\eta_1 (r_1 - \eta_1)} \eta_1^{r_1 (r_2 - r_1)} e^{-\tau_1(x-h)}. $$

4. Applications to Gerber-Shiu Functions

We consider an insurance risk model in which the insurer's surplus process is defined as

$$ U(t) = u + \mu t + \sigma W_t + \sum_{i=1}^{N_t} Y_i \equiv u + X(t) - x, \quad t \geq 0, \quad (43) $$

where $X(t)$ is defined by (1) with jump density (33). The time of (ultimate) ruin is defined as $\tau = \inf\{t \geq 0 : U(t) \leq 0\}$,
where $\tau = \infty$ if ruin does not occur in finite time. As applications, we obtain the following special case of the Gerber-Shiu functions for surplus processes with two-sided jumps:

$$
\phi_t(u) = E\left(e^{-\alpha\tau} w\left([U(\tau)]\right)1(\tau < \infty) | U(0) = u\right),
$$

$$
\phi_\alpha(u) = E\left(e^{-\alpha\tau} w\left([U(\tau)]\right)1(\tau < \infty, U(\tau) = 0) | U(0) = u\right),
$$

$$
\phi_s(u) = E\left(e^{-\alpha\tau} w\left([U(\tau)]\right)1(\tau < \infty, U(\tau) < 0) | U(0) = u\right),
$$

where $\alpha > 0$ is interpreted as the force of interest and $w$ is a nonnegative function defined on $[0, \infty)$. Note that a more general form of Gerber-Shiu function was originally introduced in Gerber and Shiu [28] for the classical risk model.

From Theorem 4(ii) we get the following result.

**Corollary 7.** Suppose that $U(t)$ drifts to $+\infty$; then one has

$$
\phi(u) = \int_0^\infty w(y) K_u^{(\alpha)}(y) dy,
$$

(45)

$$
\phi_\alpha(u) = w(0) \sum_{k=1}^{\infty} B_k A_k e^{-\tau_k u},
$$

(46)

$$
\phi_s(u) = \sum_{k=1}^{\infty} B_k \left\{ \sum_{l=1}^{m} A_k \eta_l \int_0^\infty w(y) e^{-\eta_l y} dy \right\} e^{-\tau_k u},
$$

(47)

where $B_k$, $A_k$, and $\eta_k$'s are defined as in Theorem 4 and

$$
K_u^{(\alpha)}(y) = \sum_{k=1}^{\infty} B_k \left\{ \sum_{l=1}^{m} A_k \eta_l e^{-\eta_l y} \right\} e^{-\tau_k y}.
$$

(48)

**Remark 8.** We compare our results with the existing literature. In case $\sigma = 0$ and $Y$ has a double exponential distribution, the result (45) was found by Cai et al. [4]. For $\sigma = 0$ and $\mu = 0$, the result (45) was found by Albrecher et al. [29, (3.2)]. For $\mu = 0$, the result (45) was found by Albrecher et al. [29, (9.3)]. For $\sigma = 0$ and $\mu < 0$, the results (45)–(47) were found by Cheung (see Albrecher et al. [29, PP. 443-444]).

5. Applications to Pricing

Path-Dependent Options

As applications of our model in finance, we will study the risk-neutral price of barrier and lookback options. These options have a fixed maturity $T$ and a payoff that depends on the maximum or minimum of the stock price over the entire lifespan of the option. Let the risk-free interest rate be $r > 0$. Given a strike price $K$ and the maturity $T$, it is well known that (see, e.g., Schoutens [30]) using risk-neutral valuation and after choosing an equivalent martingale measure $P$ the initial (i.e., $t = 0$) price of a fixed-strike lookback put option is given by

$$
L^P_{t,\delta}(K, T) = e^{-\tau T} E\left(\sup_{0\leq t\leq T} S(t) - K\right)^+.\quad (49)
$$

The initial price of a fixed-strike lookback call option is given by

$$
L^C_{t,\delta}(K, T) = e^{-\tau T} E\left(\inf_{0\leq t\leq T} S(t) - K\right)^+.\quad (50)
$$

The initial price of a floating-strike lookback put option is given by

$$
L^P_{\text{floating}}(T) = e^{-\tau T} E\left(\sup_{0\leq t\leq T} S(t) - S(T)\right)^+.\quad (51)
$$

In the standard Black-Scholes setting, closed-form solutions for lookback options have been derived by Merton [31] and Goldman et al. [32]. For the double mixed-exponential jump diffusion model, Cai and Kou [15] derived the Laplace transforms of the lookback put option price with respect to the maturity $T$; however, the coefficients do not determine explicitly.

We will only consider lookback put options because lookback call options can be obtained similarly. For jump diffusion process (1) with jump size density (5), the condition $\eta_l > 1$ is imposed to ensure that the expectation of $e^{-\tau t} S(t)$ is well defined.

**Theorem 9.** For all sufficiently large $\delta > 0$, one has

(i) for $K \geq S_0$,

$$
\int_0^\infty e^{-\delta \tau T} \mathbb{P}_{t,\delta}(K, T) dT = S_0 \sum_{i=1}^{N} \prod_{k=1}^{m} (1 - \beta_{i,\tau+\delta}/\eta_i) \frac{1}{r + \delta} \left(1 - \beta_{i,\tau+\delta}/\beta_{i,\tau+\delta}\right)^{\beta_{i,\tau+\delta} - 1};
$$

(ii) then

$$
\int_0^\infty e^{-\delta \tau T} \mathbb{P}_{\text{floating}}(T) dT = S_0 \sum_{i=1}^{N} \prod_{k=1}^{m} (1 - \beta_{i,\tau+\delta}/\eta_i) \frac{1}{r + \delta} \left(1 - \beta_{i,\tau+\delta}/\beta_{i,\tau+\delta}\right)^{\beta_{i,\tau+\delta} - 1} + \frac{S_0}{r + \delta};
$$

(53)

(54)
where \( \beta_{1, r+\delta}, \ldots, \beta_{N, r+\delta} \) are the \( N \) positive roots of the equation \( \psi_j(z) = r + \delta \) and

\[
N = \begin{cases} 
m + 1, & \sigma > 0, \text{ or } \sigma = 0, \mu > 0, \\
m 
\end{cases} \quad \sigma = 0, \mu \leq 0.
\]  
(55)

**Proof.** (i) We prove it along the same line as in Cai and Kou [15]. Set \( k = \ln(K/S_0) \geq 0 \); then

\[
L^P_{\text{fix}}(K, T) = S_0 e^{-rT} \int_0^\infty e^y \mathbb{P}\left( \sup_{0\leq t \leq T} X(t) \geq y \right) dy.
\]  
(56)

It follows that

\[
\int_0^\infty e^{-\delta T} L^P_{\text{fix}}(K, T) dT = S_0 \int_0^\infty e^y \left[ \int_0^\infty e^{-\delta T} \mathbb{P}\left( \sup_{0\leq t \leq T} X(t) \geq y \right) dT \right] dy \\
= \frac{S_0}{r + \delta} \int_0^\infty e^y \mathbb{P}\left( \sup_{0\leq t \leq T} X(t) \geq y \right) dy.
\]  
(57)

The result follows from Theorem 2 and (57).

(ii) Since

\[
L^P_{\text{floating}}(T) = S_0 e^{-rT} \mathbb{E}\left[ \exp\left( \sup_{0\leq t \leq T} X(t) \right) \right] - S_0,
\]  
(58)

it follows that

\[
\int_0^\infty e^{-\delta T} L^P_{\text{floating}}(T) dT = S_0 \int_0^\infty e^{-\delta T} \mathbb{E}\left[ \exp\left( \sup_{0\leq t \leq T} X(t) \right) \right] dT - \frac{S_0}{\delta} \\
= \frac{S_0}{r + \delta} \mathbb{E}\left[ \exp\left( \sup_{0\leq t \leq T} X(t) \right) \right] - \frac{S_0}{\delta} \\
= \frac{S_0}{r + \delta} \left( 1 + \int_0^\infty e^y \mathbb{P}\left( \sup_{0\leq t \leq T} X(t) \geq y \right) dy \right) - \frac{S_0}{\delta} \\
= \frac{S_0}{r + \delta} \left( 1 + \int_0^\infty e^y \mathbb{E}\left( e^{-(r+\delta)\tau^*_j} \right) dy \right) - \frac{S_0}{\delta}.
\]  
(59)

The result follows from Theorem 2 and (59).

5.2. **Barrier Options.** The generic term barrier options refers to the class of options whose payoff depends on whether or not the underlying prices hit a prespecified barrier during the options' lifetimes. There are eight types of (one dimensional, single) barrier options: up- (down) and-in (out) call (put) options. For more details, we refer the reader to Schoutens [30]. Kou and Wang [10] obtain closed-form price of up- and in-call barrier option under a double exponential jump diffusion model; Cai and Kou [15] obtain closed-form expressions of the up-and-in call barrier option under a double mixed-exponential jump diffusion model. Here, we only illustrate how to deal with the down-and-out call barrier option because the other seven barrier options can be priced similarly. For jump diffusion process (1) with jump size density (33), given a strike price \( K \) and a barrier level \( U \), under the risk-neutral probability measure \( \mathbb{P} \), the price of down-and-out call option is defined as

\[
\text{DOC} = \exp(-rT) \mathbb{E}_x\left[ \left( S(T) - K \right)^+ 1_{(\ln(U/S_0) < 0)} \right], \quad U < S_0.
\]  
(60)

Let \( h = \ln(U/S_0) \) and \( k = -\ln K \). Then

\[
\text{DOC}(k, T) := \text{DOC} = \exp(-rT) \mathbb{E}_x\left[ \left( S(T)^{X(T)} - e^{-k} \right)^+ 1_{(e^{-k} > T)} \right].
\]  
(61)

**Theorem 10.** For any \( 0 < \phi < \eta_1 - 1 \) and \( r + \varphi > \psi_1(\phi + 1) \), then

\[
\int_0^\infty \int_0^\infty e^{-\phi k - \varphi T} \text{DOC}(k, T) dk dT = \frac{S_0(1 - e^{-(\phi + 1)(h-k)\Sigma_{k=1}^l B_{r+\varphi,k}e^{-R_l(s-h)})}}{\varphi(\phi + 1)(\varphi + r - \psi_1(\phi + 1))},
\]  
(62)

where \( -R_1, \ldots, -R_l \) are the negative roots of the equation \( \psi_2(r) = r + \varphi \) and

\[
J = \begin{cases} 
m + 1, & \sigma > 0, \text{ or } \sigma = 0, \mu > 0, \\
m 
\end{cases} \quad \sigma = 0, \mu \leq 0,
\]  
(63)

\[
B_{r+\varphi,k} = \frac{\prod_{k=1}^m (1 - R_j/\eta_k)}{\prod_{k=1, k \neq j}^l (1 - R_j/R_k)}. \quad \frac{\prod_{k=1}^m (1 + (\phi + 1)/\eta_l)}{\prod_{k=1}^m (1 + (\phi + 1)/\eta_l)}.
\]  
(64)

**Proof.** Using the same argument as that of the proof of Theorem 5.2 in Cai and Kou [15], we get

\[
\int_0^\infty \int_0^\infty e^{-\phi k - \varphi T} \text{DOC}(k, T) dk dT = \int_0^\infty \int_0^\infty e^{-\phi k - (\varphi + 1)T} \mathbb{E}_x\left[ \left( S_0 e^{X(T)} - e^{-k} \right)^+ 1_{(e^{-k} > T)} \right] dk dT \\
= \frac{S_0(1 - e^{-(\phi + 1)(h-k)\Sigma_{k=1}^l B_{r+\varphi,k}e^{-R_l(s-h)})}}{\varphi(\phi + 1)(\varphi + r - \psi_1(\phi + 1))} \times \left( 1 - \mathbb{E}_x\left[ e^{-(\varphi - \psi_1)\tau^*_j(\phi + 1)(X_j)} \right] \right),
\]  
(64)

and the result follows from Theorem 4(i).
6. The Price of the Zero-Coupon Bond

In this section, we give a simple application on the price of the zero-coupon bond under a structural credit risk model with jumps. As in Dong et al. [18], we assume that the total market value of a firm under the pricing probability measure \( P \) is given by

\[
V(t) = V_0 e^{X(t) - x}, \quad t \geq 0,
\]

where \( V_0 \) is positive constant and \( X(t) \) is defined as (1). For \( K > 0 \), define the default time as

\[
\tau = \inf \{ t : V(t) \leq K \}.
\]

If we set \( x = -\ln(K/V_0) \), then

\[
\tau = \inf \{ t : X(t) \leq 0 \}.
\]

Given \( T > 0 \) and a short constant rate of interest \( r > 0 \), Dong et al. [18] have shown that the Laplace transform of the fair price \( \hat{B}(0, T) \) of a defaultable zero-coupon bond at time 0 with maturity \( T \) is given by

\[
\hat{B}(y) = \frac{1 - E [e^{-(\gamma + r)\tau}] + RE [e^{-(\gamma + r)\tau} V(\tau) 1(\tau < \infty)]}{\gamma + r} K^\gamma,
\]

where \( R \in [0, 1] \) is a constant. When the jump size distribution is a double hyperexponential distribution, a closed-form expression is obtained, but the coefficients cannot be determined explicitly (except for \( n = 2 \)). Now applying the result in Section 3.2, we get the following result.

**Corollary 11.** If the process \( X(t) \) is defined as (1) has jump size density (33), one has

\[
\hat{B}(y) = \frac{1 - \sum_{j=1}^J C_j e^{-\rho_j x}}{y + r} \gamma + r + \frac{R}{y} \sum_{j=1}^J C_j \prod_{k=1}^m \left(1 - \frac{1}{\eta_k} \right) e^{-\rho_j x},
\]

where \(-\rho_1, \ldots, -\rho_J\) are the negative roots of the equation \( \psi_2(\rho) = y + r \) and

\[
J = \begin{cases} m + 1, & \text{if } \sigma > 0, \text{ or } \sigma = 0, \mu < 0, \\ m, & \text{if } \sigma = 0, \mu \geq 0, \end{cases}
\]

\[
C_j = \frac{\prod_{k=1}^m (1 - \rho_j/\eta_k)}{\prod_{k=1}^m \left(1 - \rho_j/r_k \right)}, \quad j = 1, \ldots, J.
\]

Conflict of Interests

The authors declare that there is no conflict of interests regarding the publication of this paper.

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