

QFI – Quantitative Finance Exam

Spring 2024/Fall 2024

Important Exam Information:

[Exam Registration](#)

Candidates may register online or with an application.

[Order Study Notes](#)

Study notes are part of the required syllabus and are not available electronically but may be purchased through the online store.

Syllabus Readings

Readings listed in this syllabus may include study notes, online readings and textbooks. Candidates are responsible for all readings in their entirety, including sections such as Appendices, unless it is stated otherwise in the syllabus.

[Introductory Study Note](#)

The Introductory Study Note has a complete listing of all study notes as well as errata and other important information.

Case Study

A case study will not be used for this examination.

[Past Exams](#)

Past Exams from 2000-present are available on SOA website.

[Updates](#)

Candidates should be sure to check the Updates page on the exam home page periodically for additional corrections or notices to the current syllabus.

[Formula Package](#)

A Formula Package will be provided with the exam. Please see the Introductory Study Note for more information.

[Table](#)

A Cumulative normal distribution table will be provided with the exam.

1. Topic: Stochastic Calculus
Learning Objectives
The candidate will understand the foundations of quantitative finance.
Learning Outcomes
The candidate will: <ul style="list-style-type: none">a) Understand and apply concepts of probability and statistics important in mathematical financeb) Understand the importance of the no-arbitrage condition in asset pricingc) Understand the Ito integral and stochastic differential equationsd) Understand and apply Ito's Lemmae) Understand the Black-Scholes-Merton PDE (partial differential equation)f) Understand and apply Jensen's Inequalityg) Understand the distinction between complete and incomplete marketsh) Be able to define and apply the concepts of martingale, market price of risk, and measures in single and multiple state variable contextsi) Understand and be able to demonstrate of the differences and implications of real-world versus risk-neutral probability measures, and when the use of each is appropriatej) Understand and be able to apply Girsanov's theorem in changing measures
Resources
<ul style="list-style-type: none">• <i>An Introduction to the Mathematics of Financial Derivatives</i>, Hirta, Ali and Neftci, Salih N., 3rd Edition 2nd Printing, 2014<ul style="list-style-type: none">○ Chapter 1 (background)○ Chapters 2-3○ Chapters 4-5 (background)○ Chapters 6-15 (excluding section 8.2.4) <p>Note: Candidates should verify that their copy of the Hirta & Neftci textbook is the 3rd edition, second printing by checking that page iv, <i>Notices</i> section, begins with "Knowledge and best practice in this field...". If the <i>Notices</i> section begins "No responsibility is assumed..." it is the first printing and should be replaced.</p> <ul style="list-style-type: none">• <i>Problems and Solutions in Mathematical Finance: Stochastic Calculus</i>, Chin, Eric, Nel, Dian and Ólafsson, Sverrir, 2014 <p>Note: Candidates should study the following problems in Chin, Nel, and Ólafsson alongside the matching chapters of <i>An Introduction to the Mathematics of Financial Derivatives</i>, Hirta and Neftci to reinforce the standard techniques used in stochastic calculus. Please note that formulas from Chin, Nel, and Ólafsson are not included in the formula package.</p>

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Chin et al. Chapter	Pages	Item	Corresponding Hirta & Neftci Chapter sections
1	1 to 3	Definitions 1.1 to 1.7 (Note that statement (b) of Definition 1.7 involves integration using a measure-theoretic approach. An equally valid statement can be made using a Riemann-Stieltjes integral for continuous distributions or a sum for discrete distributions.)	5.2
	18 to 19	Q7	15.4.1
	43 to 44	Q4	14.2.2
	43 to 44	Q5	Paragraph containing equations on pg. 245 from (14.91) - (14.93)
2	52	Definitions 2.1, 2.2	8.2.1
	52	Theorems 2.3 and 2.4	5.8
	52	Definitions 2.5 and 2.6	2.2.9, 6.2
	55 to 57	Q1 to Q3	6.4.1
	57 to 68	Q4 to Q13, except Q11	8.2.1
	71	Q1	6.6.1
	72	Q2	6.6.2
	72 to 74	Q2-Q5	6.6.3
3	96 to 97	Theorem 3.2	10.4
	97 to 98	Theorem 3.3	21.4
	99 to 100	Definition 3.6	10.4
	115	Q13	First part is different approach to part of question #12 in pg. 64
	123 to 147	Q1 to Q19	10.5
	155 to 158	Q1 to Q3	10.7
	175 to 178	Q10	10.7
4	186 to 187	Definitions 4.1(a) - (f)	H&N Introduces self-financing portfolios in 6.11.3 and goes into detail in 12.3
	189	Theorem 4.6	14.3
	192 to 194	Q1	6.11 and exercise 1 in pg. 109
	192 to 194	Q2	6.11 and exercise 4 in pg. 110
	194 to 197	Q1 to Q3	14.3
	221 to 242	Q1 to Q17	15
5	262 to 264	Q9 to Q11	5.5.5, 8.2.2
	281 to 285	Q1, Q2 Jump diffusion	Chapter 11: section on pure jump framework

2. Topic: Interest Rate Models and Hedging

Learning Objectives

The candidate will understand:

- The quantitative tools and techniques for modeling the term structure of interest rates.
- The standard yield curve models.
- The tools and techniques for managing interest rate risk.

Learning Outcomes

The candidate will:

- Understand and be able to apply the concepts of risk-neutral measure, forward measure, normalization, and the market price of risk, in the pricing of interest rate derivatives
- Understand and be able to apply various one-factor interest rate models and various simulation techniques including Euler-Maruyama discretization and transition density methods
- Understand and be able to apply multifactor interest rate models
- Understand and be able to apply the Heath-Jarrow-Morton approach including the LIBOR Market model
- Understand model selection and the appropriateness to the specific purpose
- Understand and be able to apply various model calibration techniques under both risk-neutral and real-world measures
- Understand option pricing theory and techniques for interest rate derivatives
- Be able to apply the models to price common interest sensitive instruments including callable bonds, bond options, caps, floors and swaptions
- Understand and be able to apply the techniques of interest rate risk hedging

Resources

- *An Introduction to the Mathematics of Financial Derivatives*, Hirta, Ali and Neftci, Salih N., 3rd Edition 2nd Printing, 2014
 - Ch. 16-20
- *Fixed Income Securities: Valuation, Risk, and Risk Management*, Veronesi, Pietro, 2010
 - Ch. 14
 - Ch. 15 (excluding Appendix)
 - Ch. 16 (including Case Study, excluding Appendix)
 - Ch. 18 (excluding Appendix)
 - Ch. 19 (excluding Appendix)
 - Ch. 20
 - Ch. 21 (excluding Appendix)

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○ Ch. 22.1-22.4

- QFIQ-116-17: Low Yield Curves and Absolute/Normal Volatilities
- QFIQ-130-21: Interest Rate Models – Theory and Practice, Second Edition, Brigo, Damiano and Mercurio, Fabio, 2006, sections 4.2.1, 4.2.2, and 4.2.5 only
- [Interest Rate Model Calibration Study](#), SOA Research, Oct 2023
- [Understanding the Connection between Real-World and Risk-Neutral Scenario Generators](#), Aug 2022
 - Introduction
 - Section 1
 - Section 2
 - Section 3
 - Appendix D

3. Topic: Equity Option Pricing and Hedging

Learning Objectives

The candidate will understand:

- How to apply the standard models for pricing financial derivatives.
- The implications for option pricing when markets do not satisfy the common assumptions used in option pricing theory.
- How to evaluate risk exposures and the issues in hedging them.

Learning Outcomes

The candidate will be able to:

- a) Demonstrate an understanding of option pricing techniques and theory for equity derivatives
- b) Identify limitations of the Black-Scholes-Merton pricing formula
- c) Demonstrate an understanding of the different approaches to hedging – static and dynamic
- d) Demonstrate an understanding of delta hedging and explain the interplay between hedging assumptions and hedging outcomes
- e) Analyze the Greeks of common option strategies
- f) Appreciate how hedge strategies may go awry
- g) Explain approaches for relaxing the assumptions used in the Black-Scholes-Merton formula
- h) Compare and contrast the various kinds of volatility, e.g., actual, realized, implied, and forward
- i) Explain the concept of volatility smile and some arguments for its existence
- j) Compare and contrast “floating” and “sticky” smiles
- k) Describe and contrast several approaches for modeling smiles, including stochastic volatility, local-volatility, jump-diffusions, variance-gamma, and mixture models
- l) Explain various issues and approaches for fitting a volatility surface

Resources

- *The Volatility Smile*, Derman, Emanuel and Miller, Michael B., 2016
 - Ch. 1, 2 (background)
 - Ch. 3-11
 - Ch. 14
 - Ch. 17-19
- QFIQ-115-17: Which Free Lunch Would You Like Today, Sir?: Delta Hedging, Volatility Arbitrage and Optimal Portfolios
- QFIQ-120-19: Chapters 6 and 7 of *Pricing and Hedging Financial Derivatives*, Marroni, Leonardo and Perdomo, Irene, 2014

4. Topic: Applications
Learning Objectives
The candidate will be able to apply the techniques of quantitative finance to business contexts.
Learning Outcomes
The candidate will be able to: <ul style="list-style-type: none">a) Identify and evaluate embedded options in liabilities, e.g., indexed annuity, structured product based variable annuity, and variable annuity guarantee riders including GMxB, etc.b) Demonstrate an understanding of embedded guarantee risk including market, insurance, policyholder behavior, and basis risk factorsc) Demonstrate an understanding of dynamic and static hedging for embedded guarantees, including:<ul style="list-style-type: none">i. Risks that can be hedged, including equity, interest rate, volatility, and cross Greeksii. Risks that can only be partially hedged or cannot be hedged including policyholder behavior, mortality and lapse, basis risk, counterparty exposure, foreign bonds and equities, correlation, and operational failuresd) Demonstrate an understanding of target volatility funds including fund performance, guarantee cost, and risk control aspects
Resources
<ul style="list-style-type: none">• QFIQ-124-20: Variable Annuity Volatility Management: An Era of Risk-Control• QFIQ-128-20: Mitigating Interest Rate Risk in Variable Annuities: An Analysis of Hedging Effectiveness under Model Risk• QFIQ-132-21: Investment Instruments with Volatility Target Mechanism, Albeverio, Steblovskaya, and Wallbaum, 2013• QFIQ-134-22: An Introduction to Computational Risk Management of Equity-Linked Insurance, Feng, 2018 (sections 1.2-1.3, 4.7 & 6.2-6.3)• QFIQ-135-22: Structured Product Based Variable Annuities, Deng, Dulaney, Husson, McCann (sections 2 & 3)