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Parametric Insurance: An Emerging Tool for Financial Risk Management

Local governments have a duty to respond quickly and decisively to extreme events and provide continuity in critical public service through adverse circumstances. Reserves or “rainy day funds,” federal assistance, and indemnitybased insurance* programs are the primary tools governments have used to manage risk associated with events, such as natural disasters, recessions, etc., that have the potential to disrupt public services. In recent years, a type of insurance instrument called “parametric insurance” has generated interest in local governments in North America to help fulfill risk management needs that aren’t met by indemnity based insurance, federal assistance, or rainy day funds.

In this paper, we will review the most import things local governments need to know about parametric insurance, including:

- Why local governments might wish to consider parametric insurance.
- Who is using parametric insurance, including a review of the experiences with parametric of two U.S. local governments and one state government.
- How to explore the use of a parametric policy.
- A review of the advantages and disadvantages of parametric insurance.

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