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### INSURANCE AND DEVELOPING COUNTRIES

Report by the UNCTAD secretariat

#### CONTENTS

	Paragraphs
Introduction	1 - 4
Chapter I : Insurance legislation and supervision in developing countries	5 - 11
Chapter II : Investment of technical reserves of insurance concerns in the country where the premium income arises	12 - 19
Chapter III : Unified international system of insurance statistics	20 - 31

## INTRODUCTION

1. The ideas that were embodied in the recommendation concerning insurance and reinsurance adopted by the first Conference<sup>1/</sup> and resolution 13(II) concerning insurance adopted at the second session of the Conference<sup>2/</sup> reflect an important advance in the understanding of the specific problems of developing countries in this field. From these recommendations and the discussions held on this subject at the meetings of the Committee on Invisibles and Financing related to Trade, a clear line of action emerges, including inter alia the following goals: the establishment of a sound and efficient national insurance market in every developing country, the creation of national insurance and reinsurance institutions, the reduction of the net outflow of foreign exchange on account of insurance transactions and the promotion of regional co-operation as one of the means of improving the terms and conditions of international insurance transactions.

2. The International Development Strategy adopted by the General Assembly for the Second United Nations Development Decade sums up as follows the objectives as regards insurance and reinsurance in developing countries:

"Reduction in the cost of insurance and reinsurance for developing countries, especially the foreign exchange cost, will be brought about by appropriate measures, bearing in mind the risks involved, to encourage and assist the growth of national insurance and reinsurance markets in developing countries and the establishment to this end, where appropriate, of institutions in these countries or at the regional level." <sup>3/</sup>

3. In full conformity with these objectives, the secretariat of UNCTAD, acting upon the specific requests of the Committee on Invisibles and Financing related to Trade, has completed several basic studies covering some fundamental issues related to the establishment and the development of national insurance markets in developing countries.

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<sup>1/</sup> For the full text, see Proceedings of the United Nations Conference on Trade and Development, Geneva, 23 March - 16 June 1964, Vol. I, Final Act and Report, United Nations publication, Sales No. 64,II.B.11, Annex A.IV.23, p.55.

<sup>2/</sup> For the full text, see Proceedings of the United Nations Conference on Trade and Development Second Session, New Delhi, 1 February - 29 March 1968, Vol. I, Report and Annexes, United Nations publication, Sales No. E.68.II.D.14, Annex I, p.50.

<sup>3/</sup> See International Development Strategy for the Second United Nations Development Decade, General Assembly resolution 2626(XXV) of 24 October 1970, paragraph (54).

These studies deal with the general problems of adequate insurance legislation and supervision as well as with the special questions of the investment of insurance funds in the country where the premium income arises and insurance statistics. It has become clear that, in order to encourage the establishment of sound and efficient national insurance markets, governments of developing countries must take the appropriate legislative and administrative actions to ensure more effective supervision and to regulate the insurance operations which are transacted in their territories by both national and foreign insurance concerns.

4. The following three chapters present highlights of the studies carried out by the secretariat of UNCTAD and conclusions to be drawn from them - some of which were formulated by Expert Groups, convened by the Secretary-General of UNCTAD to review and comment on the studies. These studies have been submitted to the Committee on Invisibles and Financing related to Trade at its fifth session (1 December 1971).

#### Chapter I

#### INSURANCE LEGISLATION AND SUPERVISION IN DEVELOPING COUNTRIES<sup>1/</sup>

5. As was stated by the Committee on Invisibles and Financing related to Trade at its first session,<sup>2/</sup> there is a growing interest in a number of developing countries in the matter of insurance legislation and supervision. This interest is fully justified, for various reasons. First, insurance supervision provides the policy-holders with a protection which is generally considered indispensable. A relatively long period elapses between the time when the policy-holders pay their premiums and the time when the claims, arising out of risks covered by the policies, are paid by the insurance concerns. At any given moment, therefore, the latter are in possession of sums which they will have to make available to the claimants at some time or other, but of which they temporarily have the use. The insurance concerns have not always

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<sup>1/</sup> See TD/B/C.3/84 and Add.1 and 2 and Corr.1, report by the UNCTAD secretariat, and TD/B/C.3/90, report by the Expert Group on Insurance Legislation and Supervision.

<sup>2/</sup> See the Committee's report on the first part of its first session, in Official Records of the Trade and Development Board, Third Session, Supplement No.3, (TD/B/42/Rev.1) Annex I (b), paragraph 4.

managed these funds in a sufficiently responsible manner, with the result that the Governments - for the first time in some developed countries in the 19th century - have gradually been compelled to intervene. At the outset, the measures taken established certain requirements to provide minimum financial guarantees and placed the concerns under some degree of supervision. As insurance business expanded, the supervision has become increasingly strict.

6. In fact, modern insurance supervision is no longer understood as being a device to protect the interests of a restricted group of insured, since insurance business progresses along with economic development and industrialization to a point where the policy-holders tend to become virtually identical with the national community as a whole. State insurance supervision is, therefore, considered part of the State's responsibility on social and economic grounds. To assume this responsibility seems all the more necessary, particularly in the developing countries, as the legislative and administrative measures embodied in that supervision are essential for promoting the establishment in each country, of a sound and efficient national insurance market, the existence and strength of which being, as is pointed out in the UNCTAD recommendations an important requirement for the process of economic development. In addition, because of the different problems confronting the developing countries, all the economic sectors - in particular those which, like the insurance sector, play an essential rôle in the collection of national savings - should contribute effectively to the development process. To ensure that they make this contribution, legislative measures are needed designed to channel the insurance funds and reserves to investment projects of national interest. Adequate supervision, including the regulation of the investment of insurance funds, also tends to reduce the foreign exchange outflow which is inevitably provoked by the insurance and reinsurance transactions with foreign concerns.

7. The study on insurance legislation and supervision in developing countries prepared by the UNCTAD secretariat (TD/B/C.3/84) and the report (TD/B/C.3/90) prepared by an expert group convened by the Secretary-General of UNCTAD in July 1971 to comment on the study, indicate, on the basis of a thorough review of the existing systems applied in developing countries, a number of basic criteria to which these systems should conform.

8. The study of the existing systems of insurance supervision showed, as might have been expected, that most developing countries - with some exceptions - are far from having developed systems of supervision which fully meet the objectives mentioned above. In some developing countries - especially those which became independent fairly recently -

insurance supervision either does not exist at all as yet, or has entirely maintained the methods prescribed by the former colonial Powers, tailored to satisfy the regulations of the metropolitan authorities while the specific local needs were disregarded. In other words, no specific effort has been made by some developing countries since their accession to independence to regulate properly the insurance business transacted in their territories, with the consequence that their national insurance markets are not adequate and that their domestic insurance industry does not find the necessary incentives to develop on sound basis.<sup>1/</sup>

9. The insurance supervision in a number of developing countries has proved to be inadequate also as regards the standards of solvency. In some cases these standards are so strict that domestic insurers can hardly afford to observe them, and the market is forced to remain in foreign hands; in other cases they are too lenient, and there the public may be reluctant to seek protection from companies whose solvency is not always secure because they are not efficiently supervised. Legislative measures governing the investment of insurance funds are another example of cases where the requirements of some developing countries fail to fulfil the specific conditions of their capital market and where modifications could ensure a better utilization of these funds in projects of national interest, providing, at the same time, a better financial security for policyholders.

10. The main criteria according to which insurance supervision should be carried out in order to be most efficient in achieving the objectives of the developing countries in this field, are set out by the Expert Group in the following terms:

- (a) Special emphasis should be laid on the supervision of the classes covering popular insurance, those involving social aspects and long-term commitments. Thus, life, small private property and third-party liability insurance are important examples of what should be the subject of particular supervision.
- (b) Effecting insurance directly abroad, with insurers not established in the country, should be forbidden in principle. Only in cases where no cover can be provided in the country might this practice be accepted as an exception. This rule, likewise calls for the promotion of the national market, in other that an increasing number and more types of the national risks can be covered in the country.

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<sup>1/</sup> Inadequate measures may lead to a situation where the volume of insurance business of a country increases more rapidly than the absorptive capacity of its national insurance market and hence to greater dependence on foreign insurers and especially reinsurers.

- (c) Licensing of insurance concerns before they commence business should be prescribed. In this context, licensing does not mean a mere formal registration, but should be preceded by a comprehensive pre-licensing examination of the technical and economic conditions of the concern, of its plan of business to be transacted in the coming few years, of the technical skill and integrity of its managers, and of its reinsurance arrangements. Ample powers should be given to the authorities in charge of insurance supervision to appraise all the qualifications of insurance firms, to prevent untrustworthy concerns and camouflaged foreign interests (so called "front" companies and "strawmen") from entering the business.
- (d) Specific laws should be enacted to regulate the contractual relationship of insurance firms with policy-holders. In the compulsory classes of insurance, there is a conspicuous need for the standardization of the insurance contracts. In other classes of insurance, general rules covering the most important terms and conditions of the policies should also be laid down, and the policies should be supervised by the authorities in order that no obscure or ambiguous terms and no terms detrimental to policy-holders should be introduced.
- (e) The share capital and free reserves of the insurance concerns should be sufficient to ensure adequate overall solvency, corresponding to the kind and volume of the business transacted by the concerns and providing a fair safeguard against adverse fluctuations of risks. The amounts constituting these financial guarantees should, in addition, be large enough to ensure a suitable level of the company's retention capacity, and so to provide the basis for the strengthening of both the company and the national market. However, excessive requirements as regards the share capital could result in the increase of the insurance costs and might, therefore, be detrimental to policy-holders and to the national economy.
- (f) Technical reserves should be evaluated as correctly as possible and strictly verified. In general, the calculation of the reserves should be based upon adequate extrapolations (prospective methods), with due regard to experience and observed trends. The setting up of technical reserves should in principle correspond to the gross liabilities of direct insurance business without deduction for the reinsured risks. Frequent checks on the validity of "en bloc" rates of reserves are recommended.
- (g) The investment of insurance funds should satisfy the main requirements of providing security for the liabilities towards policy-holders and beneficiaries and

contributing to the supply of financial means for the country's most essential investment needs. These objectives obviously require, as recommended by the Conference at its first session, that funds allocated to cover the technical reserves and other complementary reserves are invested in the country, this condition applying irrespective of the nationality of the insurance concern. To the classical criteria of security, profitability and liquidity should be added that of diversification of the investment portfolios. No speculative investment should be accepted, but sound equities could qualify for inclusion. The holding by an insurance company of shares or participations in another enterprise should be kept to a minimum so as to exclude all possibility of acquiring a controlling interest in any outside enterprise. Each country should exercise considerable flexibility in making regulations governing the choice of authorized investments for insurance concerns. The regulations should, however, stipulate the two main requirements, namely the security of the concerns and policy-holders and the financial necessities of the country.

- (h) Tariffs, costs, reinsurance agreements, accounting and statistics, being the main elements of insurance management, should all be subject to government supervision. Tariffs, in particular, should not be either uneconomically low (the chief cause of insolvency) or excessively high, particularly, in the compulsory classes of insurance. Investment income derived from assets corresponding to the technical reserves should be taken into account in the calculation of tariffs. Sales commissions to agents and intermediaries should be commensurate with the services they offer to the public. Commissions on the sale of compulsory classes of insurance should be reduced to a minimum.
- (i) The presence of a public or semi-public reinsurance institution in a developing country, with provision for the compulsory cession of business to that institution, may provide an essential encouragement to the development of a sound national insurance market and reduce the foreign exchange outflow on account of reinsurance transactions.
- (j) Owing to the specific and very technical nature of their duties, insurance supervisory authorities should constitute an independent branch of the civil service, at a high level, responsible directly to a high-ranking government officer (Minister). These duties call for competent personnel qualified in legal, economic, accounting and actuarial matters. Special training facilities in insurance and in supervision techniques should be provided for such personnel. Co-operation among

insurance commissioners of different countries should provide opportunities for exchanging experience and information. The establishment of regional associations or of conferences of insurance supervisors should be promoted.

11. In summing up, the importance for every developing country to regulate the insurance business transacted in its territory by setting up a system of adequate insurance supervision must be re-emphasized. It is suggested, therefore that the Governments of developing countries:

- (i) examine, in the light of the conclusions of the UNCTAD secretariat's study and of the Expert Group's report, the extent to which their countries' insurance legislation and supervision correspond to the requirements of an adequate supervisory system;
- (ii) take, if necessary, appropriate measures for improving the insurance legislation and supervision systems, for which purpose technical assistance may be sought and obtained from the secretariat of UNCTAD, within the framework of UNDP;
- (iii) make full use of training facilities, to be provided by the developed countries in insurance concerns and in Government supervisory authorities, as well as by the UNCTAD secretariat within the framework of UNDP, in order to build up an insurance supervisory service staffed by persons competent to carry out insurance supervision effectively;
- (iv) establish regional or sub-regional co-operation among their supervisory authorities with a view to exchanging experience and information regarding insurance supervision and harmonizing insurance legislation.

## Chapter II

### INVESTMENT OF THE TECHNICAL RESERVES OF INSURANCE CONCERNS IN THE COUNTRY WHERE THE PREMIUM INCOME ARISES <sup>1/</sup>

12. Chapter I indicated the need for the investment of technical reserves in the country where the premium income arises. It is universally recognized that the technical reserves of insurance concerns, which de facto represent the value of the concerns'

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<sup>1/</sup> UNCTAD secretariat study TD/B/C.3/87 and Corr.1.



current commitments towards their policy-holders and third party beneficiaries, play an important economic rôle in that they lead to the accumulation of large sums for investment in the countries' economies. In view of the general scarcity of capital in the developing countries, the technical reserves of insurance concerns are of vital importance in these countries. Desiring to enable these countries to benefit from the insurance funds, the Conference recommended at its first session that "technical reserves and guarantee deposits of insurance and reinsurance companies or institutions should be invested in the country where the premium income arises".<sup>1/</sup>

13. However, an investigation carried out by the UNCTAD secretariat for the Committee on Invisibles and Financing related to Trade to determine to what extent that recommendation is being put into effect shows that as yet only relatively few developing countries have taken action to apply the principle of the investment of technical reserves of insurance concerns in the country where the premium income arises. In its new study, the UNCTAD secretariat has sought to spell out as clearly as possible the technical aspects and practical modalities of implementation of the recommendation, hoping to promote in this way its implementation by all developing countries.

14. The principle that technical reserves should be invested in the country where the premium income arises is by no means new. In fact, the practice of localizing the technical reserves of each national portfolio has long been observed in very many industrialized countries. However, the application of the principle is not uniform in all these countries and presents certain technical difficulties, some of them connected with the definition and valuation of technical reserves and others with the investment and supervision of the corresponding funds.

15. In other words, in order that technical reserves may be invested in a suitable manner, in the country where the premium income arises, with maximum benefit and without endangering the primary function of insurance (the covering of risks with absolute security and at a reasonable cost), it is essential to take due account of a number of factors, of which the most important are:

- (a) the nature of the technical reserves of insurance concerns;
- (b) the correct evaluation of technical reserves;
- (c) reserves with or without deduction for reinsurance;

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<sup>1/</sup> Proceedings of the United Nations Conference on Trade and Development, Vol. I  
Final Act and Report, Annex A.IV.23.

- (d) the type of investment suitable for insurance purposes;
- (e) the correct evaluation of investments;
- (f) the practical application of the principle.<sup>1/</sup>

16. The mathematical reserves in life insurance and the reserves for unexpired risks and reserves for outstanding claims in non-life insurance are the three main forms of technical reserves and are generally regarded as the classical technical reserves. Provided that they have been properly valued, these three reserves should normally suffice to cover the whole of an insurance concern's current commitments arising from the risks of its portfolio. Generally speaking, if they employ traditional methods of calculating the three types of technical reserves mentioned above (except, perhaps, in some cases regarding the reserves for outstanding claims) insurance concerns are unlikely to experience any extreme difficulties in evaluating correctly their pending liabilities.

17. The main characteristics of investments which are suitable for insurance purposes are the subject of another clause in the aforesaid recommendation of the first Conference, which provides that "adequate conditions of security, liquidity and income must ... be assured", in order that investments should be made in the country where the premium income arises. The above guidelines, as well as the rule that investment risks must not be allowed to accumulate, must be strictly observed by all insurance concerns which, at the same time, should also ensure that their funds are invested in a manner beneficial to the national economy.

18. In order to verify at any given moment the observance by an insurance concern of the recommendation that technical reserves should be invested in the country where the premium income arises, the following procedure should be followed: first, the evaluation of the technical reserves must be verified; next, the list of investments serving as cover for the reserves must be checked to ensure that the investments satisfy local requirements; and lastly, a check must be made to ensure that the investments shown on the list are actually located in the country and are owned by its insurance concerns.

19. In conclusion, the study suggests that:

- (i) Governments of developing countries should consider, in the light of this report, the extent to which they have implemented the recommendation that the technical reserves of insurance concerns should be invested in the country where the premium income arises;

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<sup>1/</sup> See TD/E/C.3/87 and Corr.1, Chapter II.

- (ii) the same Governments should inform the UNCTAD secretariat as soon as possible about the progress made in implementing the said recommendation in their countries and about any further measures they may contemplate with a view to improving the present situation;
- (iii) the secretariat should make available to developing countries, upon request, any assistance they may need in connexion with the implementation of the recommendation;
- (iv) the secretariat should report to the Committee on Invisibles and Financing related to Trade, at its sixth session, on the implementation of the recommendation by the developing countries.

### Chapter III

#### UNIFIED INTERNATIONAL SYSTEM OF INSURANCE STATISTICS<sup>1/</sup>

Already at its first session the Conference noted the shortage of reliable statistics on invisible transactions generally, and more specifically called for the adoption of uniform criteria for the compilation of the statistics of insurance transactions.<sup>2/</sup> The Committee on Invisibles and Financing related to Trade, in the programme of work adopted at its first session, referred to the desirability of working out minimum statistical standards and definitions and preparing meaningful and internationally comparable statistics of insurance transactions, with specific reference to the possibility of assessing the influence of international insurance transactions on the balance of payments of developing countries.

Besides their specific relevance to the problem of the balance of payments, insurance statistics have other important and fundamental functions, both at the company and at the national level. At the level of the individual insurance undertakings the insurance statistics constitute the technical background for their operations and are at the same time a major tool for the supervision of the undertakings by the insurance supervisory authority, in particular as regards the control of their financial status

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<sup>1/</sup> TD/B/C.3/85, report by the secretariat of UNCTAD

<sup>2/</sup> Proceedings of the United Nations Conference on Trade and Development, I, Final Act and Report, Annex A.IV.23.

and solvency. Such statistical information usually follows very closely the business records and accounts of an insurance undertaking which are, in turn, a source for the preparation of the annual accounts of the undertaking and official returns to be submitted to the supervisory authority.

22. At the national level, insurance statistics provide the means of carrying out a comprehensive analysis of the structure and the state of the national insurance market and also give a good deal of technical information about the conduct and the results of the insurance transactions. According to the degree of detail of the statistical information collected and compiled, annual nation-wide statistics make it possible to assess, for the whole country, the volume of the insurance business concluded by all undertakings operating in it and so to determine the size of the country's insurance market, its structure (e.g. domestic and foreign enterprises), its efficiency as a provider of insurance cover, its role in the saving of funds and its contribution to the country's development through investments in the national economy. Furthermore, conclusions can be drawn from the statistical data as to the influence of international insurance transactions on the country's balance of payments. On the technical side such statistics give an insight into the functioning of the market and its strength or weakness. They show the technical results of the insurance operations for the market on average and in every individual class of insurance transactions for which the separate data are provided. For a proper fulfilment of all these purposes it is, of course, important that all the insurance undertakings provide the basic information on an identical or at least on a fully comparable basis and that adequate means are available for collating such market information.

23. Compiled consistently over a period of years, such statistical information would reflect the development and evolution of the market and so permit the periodic adjustment of the regulations governing the insurance business in a particular developing country with a view to building and strengthening its national insurance market and guiding the economic activities of the insurance industry in such a way that they serve best the country's economic development.

24. All these essential aspects and requirements are taken into account in the UNCTAD secretariat's recent study of this subject,<sup>1/</sup> prepared with the assistance of a group of experts convened by the Secretary-General of UNCTAD in Geneva from 7 to 15 October 1970

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<sup>1/</sup> Establishment of a unified international system of insurance statistics, report by the UNCTAD secretariat (TD/B/C.3/85).

25. The core of the recommended unified system of insurance statistics is what is called in the report "the national monograph", to be prepared by the supervisory authority of each country on the basis of the statistical information received from the individual insurance undertakings. But a unified presentation of statistical information at the national level has to be preceded first, by the standardization of the primary elements of the system, and secondly, by the definition of the basic notions on which the whole system rests. Accordingly, the recommended system has as its primary source of information the traditional forms of the business records, namely the profit and loss account and the balance sheet, which are kept and maintained by every insurance undertaking in the normal course of its business. The major problem here was how to overcome the differences in practices existing not only among various countries, which arise mostly from the conceptual, legislative and supervisory approaches, but also the differences, although of a minor nature, in methods and practices of recording and accounting of individual companies.

26. As a first approach to the unification of the primary sources of information it was decided, therefore, to work out a unified break-down of all the primary elements or items which are relevant to the profit and loss account in this broad sense, both on the income and on the expenditure sides, and agree upon the classification of all the items of assets and liabilities for the balance sheet.

27. Having specified the minimum initial requirements, the system provides for two sets of series, one for the use of the insurance undertakings producing the basic data, and the other for the supervisory authority preparing the national monograph. It should be emphasized at this stage that the collection of the series designed for the undertakings should be carried out in a comprehensive manner, so that all types of undertakings dealing with insurance are included in the national monograph. Consequently each and every undertaking would be required to fill in a set of forms which have been worked out for the purpose and accompany them with explanations, if required.

28. The second set of forms is designed for the national monograph. It follows precisely the nomenclature of the original items in the individual undertakings' forms with regard to both the elements of the profit and loss account and the technical results. The first important series includes the forms showing the trading results of the national portfolio, and provides three separate columns of figures for the gross direct business and the net retained business for each type of insurance concern:

State institutions, domestic private undertakings,<sup>1/</sup> foreign branch offices and agencies, with subdivisions into life insurance and all other classes of business. The technical results for direct business on the basis of gross figures in each class of business are further elaborated by means of a special set of forms. Two further tables are provided, one showing the technical reserves of the national portfolio together with data on the paid-up capital and the free reserves of the insurance undertakings operating in the country, and the other giving an analysis of the types of investments shown in the balance sheet divided into types of insurance undertakings and indicating whether the investment is made in domestic or in foreign assets.

29. As the unified international system of insurance statistics is designed principally for developing countries, it was considered especially important that it should lay down only the minimum requirements for the compilation of the statistical tables, with a view to reducing to a bare minimum the costs of its introduction. As a matter of fact, many countries, especially the developed market economy countries, and some developing countries whose insurance markets are in an advanced stage of development, would have to make only minor adjustments in their existing arrangements to conform to the proposed new system. There is, however, a larger group of developing countries whose national statistical systems are either non-existent or inadequate. These countries would have to cope with the problem in any case. If, therefore, they can commence the necessary work in the knowledge that the results of their efforts will be in line with internationally acceptable standards, they would not only be encouraged to follow the recommended course of action more energetically, but may also hope to achieve their purpose with less expenses than they would have incurred, if they had undertaken it individually.

30. Even though this is only a minimum system and can be considered as the first step towards bringing closer together the conceptual approaches of various insurance markets of the world, it is sufficient for an analysis of the insurance market and for the effective supervision of its operations. Further, the meaningful and comparable data covering the operations of the national markets and measuring the impact of the international insurance transactions, including those of reinsurance, will make it possible to quantify these activities on an international scale and to measure their

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<sup>1/</sup> With an optional additional classification into genuinely domestic and foreign-owned companies (subsidiaries).

economic impact. In fact, the main innovation of the unified international system of insurance statistics is the clear-cut separation in reporting the insurance business underwritten by the domestic sector and the foreign sector of the national insurance market as well as the business which goes directly abroad or originates from abroad. This innovation meets the most important requirement of developing countries as expressed in UNCTAD resolutions directed at the development and strengthening of the national insurance markets in developing countries and the objectives of the Second Development Decade.<sup>1/</sup>

31. Developing countries, by using the proposed unified international system of insurance statistics, would be able not only to know their insurance market better, but also to work out and take all the necessary measures to regulate that market so that it would best serve the insured and the process of economic development. They will also benefit by having comparable data about insurance markets of other countries. It should therefore be recommended that the Governments of the member countries of UNCTAD, in particular of the developing countries:

- (i) introduce the unified international system of insurance statistics as proposed in document TD/B/C.3/85 or, where appropriate, adapt their present system of insurance statistics in order to make it compatible with that unified system;
- (ii) make use, if necessary, of the technical assistance which could be provided by the UNCTAD secretariat in this connexion, as far as developing countries are concerned, within the framework of UNDP;
- (iii) inform in due course the UNCTAD secretariat of the implementation of this recommendation in their countries, so that the secretariat can report to the appropriate UNCTAD bodies.

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<sup>1/</sup> See paragraph 2 above.