

**TRADE FORWARD**  
SOUTHERN AFRICA

# KNOWLEDGE GUIDE SERIES

## Better understanding the INCOTERMS



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### 1 What are Incoterms, and what purpose do they serve?

**Incoterms** - short for '**International Commercial Terms**' - are a set of trading terms and conditions designed to assist companies when goods are sold and transported internationally, and geared to providing a common understanding on where risks and responsibilities pass between sellers and buyers. Incoterms are expressed as three-letter-acronyms, and are individually defined. The latest internationally agreed list contains 11 Incoterms (see the following page for details).



### What are the three main purposes of Incoterms?

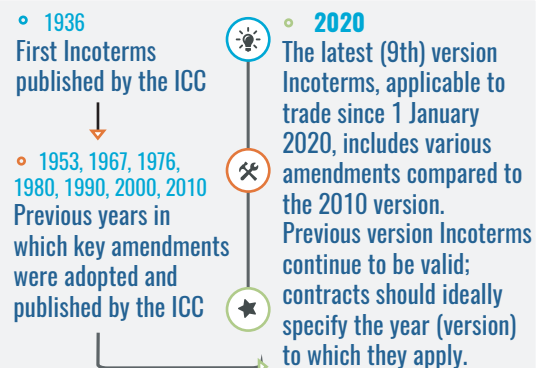
▶ <b>'Carriage'</b>	An international journey usually involves a number legs, and the chosen Incoterm defines exactly which part of the journey the seller takes responsibility for, and from what point onwards the buyer assumes responsibility for arranging carriage.
▶ <b>'Cost'</b>	Each Incoterm also sets out who is responsible for the payment of the costs of the journey, how these costs are reflected in the overall transaction, and the extent to which these are specified in the invoice value of the goods.
▶ <b>'Risk'</b>	The international journey of a good, especially where it involves multiple legs, has many points of risk. The chosen Incoterm used in a transaction sets out exactly which of the parties carries the burden of risk, for which parts of the journey.

### 3 Why use Incoterms in international trade?

- **Incoterms** provide a common language that allows traders to set and agree some of the key terms of their transaction. By incorporating **Incoterms** into the sales contract, buyers and sellers can achieve a common understanding on exactly what each party agrees to do, what the risks are, but also where responsibility lies in the event of loss or damage.
- **Incoterms** are not mandatory and must be explicitly incorporated into a contract by the parties concerned in order to be of legal effect. Used correctly and appropriately, **Incoterms** provide clarity to buyers and sellers about which party is responsible for which aspects of a transaction, especially as it relates to the delivery of the goods. Since there is often significant time that passes between goods leaving the premises of the seller, and arriving at the buyer's premises, **Incoterms** are used to specify at what point the risk, responsibilities and ownership of the respective goods pass from one party to the other, and what exactly these risks and obligations are.
- Without internationally harmonised **Incoterms**, the task of describing these conditions would be far more complex, and would likely involve many pages of contracting.

### 2 A brief timeline Incoterms: From 1936 to the present

The first **Incoterm** rules were published by the International Chamber of Commerce (ICC) in 1936, in response to a need for harmonised definitions and rules to help facilitate international trade. The 9th version of **Incoterms** definitions applies since 1 January 2020. The previous definitions remain valid where already in contractual use, but trade contracts should specify which version they relate to, otherwise in a case of dispute the currently applicable version at the time of contracting would likely



#### Each Incoterm specifies:

- The **obligations** of each party (who is responsible for aspects such as transportation, import and export clearance, etc.)
- The point in the transport journey where **risk transfers** from the seller to the buyer

## 4 Incoterms: Benefits, risks and insurance considerations



### Benefits and risks

The main advantage of Incoterms is that they offer the use of standardised terminology to companies engaged in international business. Their correct use reduces the risk of trade disputes, disagreements and possible financial losses, should the trade process not happen in the way that was expected by the parties involved.

Risks and responsibilities include understanding the correct meaning of Incoterms, and using the appropriate Incoterm in each trade transaction that fulfils the respective needs of the contracting parties. Unsuitable Incoterms can result in unexpected costs, risks and disputes, and often impact the business relationships between a buyer and seller, as well as the business itself.

### Insurance

Most Incoterms are silent on the issue of insurance, and it is up to the contracting parties to decide on whether they would like insurance for the part of the journey that they bear the risk of damage or loss for. Only two of the incoterms (**CIF** and **CIP** - see next sections) impose specific obligations on the seller to provide insurance for the shipment, up to a certain point of the journey.

The contractual delivery point under a specific Incoterm, being the point at which risk is transferred from the seller to the buyer, must be established when buying insurance cover. This is because each party must determine whether it has an insurable risk in the goods, without which the cover obtained may not be valid. It is also important to note that the passing of risk does not always happen at the same point where the responsibility for cost obligations change.

## 5 How many Incoterms are there?

The 2020 edition ('Incoterms 2020') covers 11 different Incoterms, unchanged from the previous (Year 2010) version (albeit with certain changes), and two fewer than the 13 Incoterms used in the Year 2000 version. The Incoterms can be divided into 2 categories, namely rules that can be applied to any mode or modes of transport (7 out of 11 Incoterms) and those that are relevant only to maritime and inland waterway transport (4 out of 11 Incoterms).

The 11 terms can also be further divided into 4 principal groups (Group E, F, C and D) depending on the party that bears responsibility for the bulk of the delivery obligations (i.e. with the seller, or the buyer). The group names correlate with the starting letter of the respective Incoterms.

	All modes of transportation	Inland waterway and maritime transportation
GROUP E	1. <b>EXW</b> <i>Ex Works</i>	
GROUP F	2. <b>FCA</b> <i>Free Carrier</i>	8. <b>FAS</b> <i>Free alongside Ship</i> 9. <b>FOB</b> <i>Free on Board</i>
GROUP C	3. <b>CPT</b> <i>Carrier Paid To</i> 4. <b>CIP</b> <i>Carrier and Insurance Paid To</i>	10. <b>CFR</b> <i>Cost and Freight</i> 11. <b>CIF</b> <i>Cost Insurance and Freight</i>
GROUP D	5. <b>DPU</b> <i>Delivery at Place Unloaded</i> 6. <b>DAP</b> <i>Delivery at Place</i> 7. <b>DDP</b> <i>Delivery Duty Paid</i>	

#### Group E ('Departure')

Seller's obligation ends at factory door

The seller makes the goods available to the buyer at the delivery point indicated by the seller, and is not responsible for customs or export clearance, and does not carry the risk and costs of loading. Risk passes at this stage.

#### Group F ('Main Carriage Unpaid')

Seller's obligation ends at vessel

The seller is responsible for delivery of the goods to an agreed place up to the port of loading (alongside ship or onboard), at which point the risk and cost obligations pass to the buyer.

#### Group C ('Main Carriage Paid')

Carriage and related charges covered by the seller

The seller is responsible for transport costs to the destination port or even place of destination, as well as for export clearance, although risk is transferred to the buyer earlier.

#### Group D ('Arrival')

Seller is generally responsible for delivery up to buyer's premise

The seller is obliged to deliver the goods to a specific place, or the port of destination, and assumes the costs thereof. The risk to the buyer also passes upon delivery.

## 7 Costs, risks and responsibilities

Schematic overview of the 2020 Incoterms, illustrating the seller's and buyer's responsibilities for costs, and where risks pass from one party to the other. Note that for some terms, risk and responsibility for costs passes at the actual place specified (i.e. agreed place, or place of destination), which would impact the diagram below.

## 5 Incoterms 2020: key changes from the previous (2010) version

The Incoterms 2020 contain a number of changes. See the highlights alongside:

Also see separate guides to individual Incoterms on the [TFS website](https://www.tfsouthernafrica.org): [tfsouthernafrica.org](https://www.tfsouthernafrica.org)

	Country, city, place of origin	Transportation	Country, city, place of destination
EXW	Ex Works	Agreed Place	
FCA	Free Carrier	Agreed Place	
FAS	Free Alongside Ship	Port of Loading	
FOB	Free on Board	Port of Loading	
CFR	Cost & Freight	Port of Destination	
CIF	Cost, Insurance & Freight	Port of Destination	
CPT		Carrier Paid to	Port of Destination
CIP		Carrier and Insurance Paid to	Port of Destination
DPU		Delivered at Place Unloaded	Place of Destination
DAP		Delivered at Place	Place of Destination
DDP		Delivered Duty Paid	Destination

Legend: Seller's responsibility (orange), Buyer's responsibility (blue), Transfer of risk from seller to buyer (yellow lightning bolt)

### Changes to FCA

FCA (Free Carrier) now allows Bills of Lading to be issued after loading, thereby satisfying the conditions of a Letter of Credit. Previously exporters often preferred to use FOB (Free on Board) to arrange payment under a Letter of Credit despite FCA being more suitable for the shipment of containerised goods.

### Changes to CIP

The term CIP (Carrier and Insurance Paid To) sees changes to the insurance coverage requirements, with the seller having to purchase a more comprehensive level of insurance. Alongside CIF, it is one of two terms where the seller bears responsibility for purchasing insurance in the buyer's name.

### DAT renamed DPU

DAT (Delivery at Terminal) is renamed Delivered at Place Unloaded (DPU). The term 'terminal' was considered confusing, and the replacement term now covers all delivery options.

### Security Provisions

Increased security provisions and cost allocations: more details around security cost allocations are now provided in the interpretation rules that accompany the Incoterms.

### Own Transport

While it was previously assumed that a third party would undertake all transport, the Incoterms 2020 allow for the provision of the buyer's or seller's own methods of transport (for example, own trucks or aircraft).