

Our ref. GB/PJK/NH

19 January 2018

Construction Unit
Department for Business, Energy & Industrial Strategy
1 Victoria Street
London SW1H 0ET

Email: constructionpayment.consultations@beis.gov.uk

Dear Sir/Madam

RESPONSE OF THE CHARTERED INSTITUTE OF CREDIT MANAGEMENT TO: THE DEPARTMENT FOR BUSINESS, ENERGY & INDUSTRIAL STRATEGY– RETENTION PAYMENTS IN THE CONSTRUCTION INDUSTRY

The Chartered Institute of Credit Management ([CICM](http://www.cicm.com)) is the largest recognised professional body in the world for the credit management community. Formed over 75 years ago, the Institute was granted its Royal Charter in 2014. Representing all areas of the credit and collections lifecycle, it is the trusted leader and expert in its field providing its members with support, resources, advice, and career development as well as a networking and interactive community. In addition to its comprehensive suite of qualifications and learning opportunities, events and magazine 'Credit Management', the CICM administers the [Prompt Payment Code](#) for BEIS. Independently, and through collaboration with business organisations, it provides vital advice to businesses of all sizes on how best to manage cashflow and credit.

CICM members hold important, credit-related appointments throughout industry and commerce, and we feel it appropriate to comment on this consultation.

We attach the responses to questions posed in the consultation paper which are most relevant to our members.

If we can help in any further way please do not hesitate to contact us.

Yours sincerely



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Chair of Technical Committee

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Questions

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If responding on behalf of a representative body please make it clear who the organisation represents and, where applicable, how the members' views were assembled:

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Please select which best describes you or your organisation:

	Respondent type
<input type="checkbox"/>	Business representative organisation / trade body
<input type="checkbox"/>	Central government
<input checked="" type="checkbox"/>	Charity or social enterprise
<input type="checkbox"/>	Individual
<input type="checkbox"/>	Construction business
<input type="checkbox"/>	Civil engineering business
<input type="checkbox"/>	Legal representative
<input type="checkbox"/>	Local government
<input type="checkbox"/>	Trade union or staff association
<input type="checkbox"/>	Other (please describe) Click here to enter text.

The consultation seeks to establish whether people agree with the statement in the impact assessment that existing prompt and fair payment measures do not fully address the specific challenges with retentions.

Consultation Question

1a. To what extent do existing prompt and fair payment measures, such as the Construction Supply Chain Payment Charter, Project Bank Accounts and the Public Contracts Regulations, help to address the specific challenges with retentions?

Answer : They are all positive measures that contribute to addressing the challenges of retentions but they are not sufficient to resolve all the issues created.

Consultation Question

1b. Please explain the reasons for your answer to question 1a.

Answer : Retentions remain a real problem for the entire industry, and particularly for smaller contractors

Consultation Question

2a. Are there any challenges that these do not address?

Answer : The broader and more generic issues identified by the Pye Tait research

Consultation Question

2b. Please explain the reasons for your answer to question 2a.

N/A

Section B – Supporting documentation

The Pye Tait research – Retentions in the Construction Industry and BEIS Consultation Stage Impact Assessment

Research

The independent research accompanying this consultation, BEIS Research Paper no. 17 – Retentions in the Construction Industry¹⁵, draws a number of conclusions and areas for potential further investigation:

- Retention monies being lost to contractor insolvency affects a large proportion of contractors who use retentions. Whilst the evidence indicates that the number of contracts affected is small, the value lost could still be significant.
- A proportion of construction customers may be making payment of the retention conditional on the performance of obligations under another contract.
- The extent to which late and non-payment of retentions has been unjustifiably withheld by contractors.
- Alternative methods of security in lieu of retentions used in England.
- The suitability and feasibility of wide use of a retention deposit scheme and holding retentions in a trust account for the construction sector.

The consultation seeks to establish whether people agree with the findings and conclusions of the independent research.

¹⁵ [BEIS Research Paper No. 17: Pye Tait Retentions in the Construction Industry October 2017](#)

Consultation Question

3a. Do you agree with the findings and conclusions drawn from the Pye Tait research?

Answer: Yes

Consultation Question

3b. Please explain the reasons for your answer to question 3a.

Answer : It has identified the vast majority of current issues

Consultation Question

4. Do you have any further comments on the Pye Tait research?

Answer : No

Consultation Stage Impact Assessment

The Consultation Stage Impact Assessment¹⁶ uses the findings from the Pye Tait research and other available evidence to provide the Government's initial assessment of the rationale for intervention, and possible options that are being considered for mitigating the issues associated with retentions in the construction payment (namely unjustified non-payment and late payment, and non-payment due to upstream insolvency). It also provides a detailed assessment on the costs and benefits of the policy and the regulatory impact. Where possible, it has used the available evidence and a range of assumptions to produce monetised estimates for a number of the key cost and benefits of the policy options considered.

The consultation seeks to establish whether people agree with the estimates, methodologies and assumptions in the Consultation Stage Impact Assessment.

¹⁶ [BEIS Consultation Stage Impact Assessment – Retention payments in the construction industry](#)

i) Value of retentions held in the construction sector as a whole

The Impact Assessment estimates that the total amount held in retentions in the construction sector in England over the course of a given year is £3.2 billion to £5.9 billion with a central estimate of £4.5 billion (in 2015 prices).

Consultation Question

5a. Do you think this estimate is reasonable?

Answer : We have no basis on which to make an opinion

Consultation Question

5b. If no, please explain the reasons for your answer to question 5a.

N/A

i-i Methodology

The methodology to derive this estimate involves multiplying the average typical retentions value obtained from Pye Tait by turnover and then taking account of the number of contractors that do not have experience of using retentions and the proportion of contracts that do not have retentions on them.

Retentions are a proportion of contract value, therefore, we believe that sector turnover is an appropriate basis for estimating the total amount held in retentions over the course of a given year. The Pye Tait research shows that retentions are not held by all construction customers or on all construction contracts thus the Impact Assessment also takes these two factors into account.

Consultation Question

6a.	Do you agree that this is a suitable methodology for estimating the total amount held in retentions across the sector over the course of a year?
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Answer: Yes

Consultation Question

6b.	If no, please explain the reasons for your answer to question 6a. If you think that an alternative methodology is needed, please provide details and supporting evidence.
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N/A

Consultation Question

7a.	Do you agree that, as retentions are a proportion of contract value, sector turnover is a more appropriate basis for estimating the total amount held in retentions over the course of a given year than sector output?
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Answer: Yes

Consultation Question

7b.	If no, please explain the reasons for your answer to question 7a. If you think that an alternative methodology is needed, please provide details and supporting evidence.
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N/A

i-ii Assumptions

The methodology in the Impact Assessment which estimates the value of retentions is based on several assumptions:

1. The average typical retention percentage is 4.85%, taken from Pye Tait survey evidence.

Consultation Question

21a. Approximately, what was the total value of retentions due to be released to you over the last year?

N/A

Consultation Question

21b. If retention money was due, approximately what proportion of this was not released?

N/A

Consultation Questions

22. Please provide further details on the reasons for this non-payment:

	The company holding the retention became insolvent	Payer cited that obligations under another construction contract had not been met	Other reasons
What proportion of the total <u>value</u> of retentions <u>not released</u> to you was because of: (Note: this row should add to 100%)	N/A		

Consultation Questions

28. Please provide further details on the reasons for this late-payment:

	Payer cited that obligations under another construction contract had not been met	Other reasons
What proportion of the total <u>value</u> of retentions <u>that was paid late</u> was because of: (Note: this row should add to 100%)	N/A	

iv) Late payment for 'other reasons'

Consultation Question

29a. Of the late-payment for 'other reasons' in question 28 above, in your view, what proportion was unjustified within the contract terms?

N/A

Consultation Question

29b. Please explain the reasons for your answer to question 29a, and if possible provide supporting evidence.

N/A

Consultation Question

30. For the amount that you believe was 'unjustified' what was the typical length of delay?

N/A

v) Late-payment because the payer cited that obligations under another construction contract from another company had not been met

Consultation Question

31a.	Did you challenge the late payment that occurred due to the payer citing that obligations under another construction contract had not been met (outlined in question 28)?
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N/A

Consultation Question

31b.	Please explain the reasons for your answer to question 31a.
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N/A

vi) 2011 amendments to the "Construction Act"

Consultation Question

32a.	Are you aware that the 2011 amendments to the "Construction Act" mean it is no longer possible to make payment, including retention payments, conditional on the performance of obligations under another contract?
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Answer: Yes

Consultation Question

32b.	Over the past year, approximately what proportion of contracts issued to you were inconsistent with the 2011 amendments that payment cannot be made conditional on performance under another contract?
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N/A

Section E – Existing alternative mechanisms to retentions

The effectiveness of existing alternative mechanisms to retentions

The Pye Tait research considered a number of mechanisms already in use within parts of the construction sector, to assess the extent to which they could be used as sector-wide alternatives to retentions. These were:

- Project Bank Accounts (PBAs);
- Retention bonds;
- Performance bonds;
- Escrow stakeholder accounts;
- Parent company guarantees; and
- Retentions held in trust.

For each of the above, the research examined how they operated, estimated costs and suitability as a sector-wide alternative to retentions. In assessing suitability four main criteria were used; applicability to the whole sector, elimination of critical issues associated with the practice of retentions, surety against defects and costs.

Additionally, respondents (clients and contractors) made a number of suggestions about other alternatives to retentions such as procurement frameworks, insurance policies, guarantees and warranties, existing legislation and retention deposit schemes.

The research indicated that there is a need to further investigate the suitability and feasibility of a wide use of alternative mechanisms to retentions in the construction sector in England, but in the first instance a “retention deposit scheme” and holding retentions in trust.

The consultation questions seek to establish the use and range of alternative mechanisms and their effectiveness in providing surety against defects and critical issues associated with retentions.

Section F – Retention deposit schemes

The scope, operation, features and potential costs of holding retentions in a retention deposit scheme

The practice of holding retentions is widespread in the construction sector but it can be associated with a number of negative impacts for contractors and the sector as a whole. In particular, the cascade system of payment in the industry, and the fact that an insolvency further up the supply chain can cause that cascade to stop, can make exposure to insolvency particularly acute to a participant further down the supply chain. This is particularly magnified by the practice of cash retention where the money can be held for extended periods after the project has been completed, coupled with being typically held in a main bank account rather than a separate account protected from the risk of insolvency.

The Pye Tait research explored the evidence for alternative mechanisms to retentions both in the UK and in a number of other countries. The research concluded that the most likely alternatives to retentions are those which appear to be applicable to the whole of the sector, eliminate some of the potential difficulties associated with retentions (notably the risk of delayed or non-payment of retention monies) and still provide the insurance mechanism for the customer.

The research particularly noted that a number of other countries required, in some respect or other, for the retention money to be held in trust in a separate, ring-fenced account until it is either used to rectify defects or becomes due for payment.

Construction projects can sustain highly complex supply chains with numerous interactions.

The impact assessment underpinning the 2011 changes to the “Construction Act” suggested that there were 432,000 main contract payments in 2005 (the last year for which that data was collected).¹⁷ Research undertaken for BIS in 2013¹⁸ found that it was not uncommon for a tier 1 contractor to have 50 to 70 tier 2 contractors. The same research found that complex tier 2 sub-contracts are also highly disaggregated, typically featuring over 30 contractors at tier 3. This complexity of interaction drives up the costs associated with any intervention. The relatively small expense of an additional transaction (such as treating retention money separately and depositing in trust at stage payments) is multiplied many times to arrive at a significant cost for the whole sector.

¹⁷Department for Business, Innovation and Skills (2011). Final Impact Assessment: Revision of the Scheme for Construction Contracts (England and Wales) Regulations 1998 Construction Contracts (England) Exclusion Order 2011 http://www.legislation.gov.uk/ukia/2011/324/pdfs/ukia_20110324_en.pdf

¹⁸ [BIS Research paper no.145: Supply chain analysis into the construction industry October 2013](#)

The Governments of New South Wales, Australia and New Zealand have acknowledged this point in their legislation protecting retention money. In New South Wales the requirement to place retention money in a trust fund is limited to tier 1 contractors and to projects over AUD\$ 20 million. Legislation in New Zealand came into force in March 2017. Retention money must be held on trust, unless a complying financial instrument, such as an insurance or payment bond is obtained.

The Pye Tait research indicates that there is frequent late and non-payment of retention monies, and that this is more pronounced for retention payments to sub-contractors at tier 2 and 3 of the supply chain. Imposing a contract or project value threshold, or limiting the application of any intervention to a single point in the supply chain, would therefore not address the problems that can be created by the practice of retentions within the construction supply chain.

Rather than imposing a threshold, or applying any requirement to a single point in the supply chain, we are therefore consulting on a proposal for retention monies to be held in trust in a separate, ring-fenced account. The features and operation of the retention deposit scheme could be developed in a number of ways. For example, retention monies associated with practical completion and defects liability period could be paid into the scheme at each stage payment or just those retention monies associated with the defects liability could be paid in one lump sum at the start of the defects liability period. There may well be other design options.

In order to further minimise burdens, any measure to require the use of trust accounts for retention money needs to be simple, consistent and transparent, particularly if it is to benefit small firms in the construction supply chain. It is believed that a “retention deposit scheme”, similar to the “Tenancy Deposit Scheme”, represents the best way of achieving this.

This consultation seeks to explore the design, costs and benefits of introducing a “retention deposit scheme” for the retention money.

It is the case that there are wider costs and benefits to the economy, and to parties not subject to construction contracts associated with these proposals. These are being considered in parallel to this consultation.

A Retention Deposit Scheme

Drawing on international experience, and experience of similar schemes such as the tenancy deposit scheme, it is envisaged that the requirement to hold retentions in a “retention deposit scheme” would have the following features:

- the scheme should be set up on a statutory footing;
- the market will deliver private provision of any retention deposit scheme(s);
- businesses holding retentions under construction contracts (as defined by Part 2 of the Housing Grants, Construction and Regeneration Act 1996) will be required to deposit retentions in the scheme;

- b. The market will deliver private provision of any retention deposit scheme(s).
- c. Businesses holding retentions under construction contracts (as defined by Part 2 of the Housing Grants, Construction and Regeneration Act 1996) will be required to deposit retentions into the scheme.
- d. The scheme can only hold retention money (plus any related interest).
- e. The money will be held in trust for the payee.
- f. Where the contract makes no such provision, the Scheme for Construction Contracts will imply relevant terms requiring retention money to be held in a deposit scheme.
- g. Scheme operators would be required to report on an annual basis on their performance.
- h. Any disputes about the operation, amount and timing of the release of retentions payments will be dealt with by existing dispute resolution processes.

Answer: Yes

Consultation Question

46i.	Please explain the reasons for your answers.
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N/A

Consultation Question

47.	Are there any further features to the retention deposit scheme that you would recommend?
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Answer : No

iii) Operation

Consultation Questions

48
a - e.

It is proposed that, if established, a retention deposit scheme would operate according to the principals listed below.

Do you agree that the following features should be included?

- a. Organisations withholding retention payments will be required to register with a scheme as an account holder.
- b. The retention holder to register specific contracts and the relevant information (such as start and end dates, payment schedule and retention terms).
- c. The retention holder to notify the scheme of the timing, amount and allocation of retention money which is being deposited.
- d. The retention holder to notify the scheme if any changes are made to the timings and payment due, and why.
- e. The scheme operator to pay the retention on the retention release date.

Answer: Yes

Consultation Question

48f.

Please explain the reasons for your answers.

N/A

Consultation Question

49.

Are there any further features to the operation of the “retention deposit scheme” that you would recommend?

Answer : No

Consultation Question

53. If you have had retentions held from you, what cost per contract would you be willing to incur if it meant that your retention was held in trust in a retention deposit scheme?

N/A

Consultation Question

54. If you currently hold retentions, above what cost per contract for the retention deposit scheme do you think you would no longer choose to hold retentions on your contracts?

N/A

Consultation Question

55. Changes to how retentions can be held would mean that parties to construction contracts would need to familiarise themselves with new guidance. How much time do you think it would be reasonable to expect you to spend reviewing guidance to familiarise yourself with any changes?

N/A

Consultation Question

56. What was the total number of contracts that you issued last year on which you hold retentions?

N/A

Consultation Question

57. Do you have any other comments that might aid the consultation process as a whole?

Answer : No