Federation of Master Builders (FMB) response to the Economy, Infrastructure and Skills Committee consultation on Retention payments in the construction sector

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About the FMB

The Federation of Master Builders (FMB) is the largest trade association in both Wales and the UK construction industry. With over 8,000 member companies, it is the recognised voice of small and medium-sized (SME) construction firms. Established in 1941 to protect the interests of construction SMEs, the FMB is independent and non-profit-making, lobbying continuously for members' interests at national (Wales), UK and local level.

Response

There are positives and negatives to the use of retentions in the construction industry.

Benefits of retentions:

- no construction project is defect-free
- Security of contractor having to return to site to remedy defects
- Some insurance against the risks of downstream insolvency (subcontractors going bust and having to be replaced)

Problems with retentions:

- (In)security of retention payment in the event of upstream (contractor) insolvency
- Prompt release of retention monies when due

Impact of upstream insolvency:

The collapse of Carillion is a case in point. When Carillion went into liquidation in January 2018, one FMB member lost over £200,000 in unpaid contracts and one member had to put their company into liquidation.

The case of Carillion highlighted structural issues associated with contracts and payment practices within the supply chain.

When smaller firms work for a larger contractor like Carillion they are essentially investing in their business and projects because they invest significant resources upfront.

Impact of late payment:

Late payment disproportionately affects SMEs because they must use scarce resources chasing late payment. Where possible, SMEs do not work with businesses that pay late, but in many cases they'll have no choice. Furthermore, SMEs cannot charge interest on late payment because any future relationship with that business would be seriously damaged. This imbalance of power in the industry is the main cause of long payment terms.

Results from a 2014 industry survey of members of the NSCC (now part of BuildUK) and of the FMB found that 12.5% of retentions were written off as bad debt.

Alternatives to the use of retentions:

A Statutory abolition of retentions as a practice

This would require the development of the market for providing alternative forms of surety.

- Options are either a ban, or a ban with some form of mandated alternative – e.g. bonds, or insurance that would act as a guarantees of contractor performance.

- For a ban on retentions, the key question is whether the market for alternative products would expand, or whether clients/high tier contractors would accept no form of surety for work. It is likely some firms would not be able to obtain or afford the market alternatives.

- The cost of market forms of surety would be disproportionately higher for firms lower down in the supply chain.

- Mandating alternative forms of surety is the approach followed in other countries.

- It may not stop all abuses and may trigger the substitution of other forms of bad payment practice.

Statutory retention deposit scheme (RDS)

Retention monies to be held in an independently operated deposit scheme or an insurance policy held covering retentions.

Introduces a requirement to place withheld monies in an independent scheme or hold insurance policy.

Pluses:

- It would provide security against insolvency and protection against poor retention payment practices.

Minuses:

- A custodial RDS design would lock money out of the supply chain and so potentially increase cost pressures for those further up the supply chain/the client.

- This option may entrench the practice of cash retentions – would be an obstacle to the aim of abolition.

- It may not stop all abuses and may trigger the substitution in other forms of bad payment practices.

- Nature and complexity of supply chain creates potentially complicated and costly RDS design.