Federation of Piling Specialists

FPS Statement: The Use of Retention Bonds

- The most prevalent form of protection against non-performance on a construction project is cash retention. In a recent survey carried out by the University of Reading on behalf of the Reading Construction Forum, 77% of all projects surveyed used a retention fund.

  On average they represent 3% of contract value and cost, in real terms, the loss of interest on the money held which represents approximately 0.2% of the contract value per year of the contract. This is not, however, deemed to be the most significant factor when considering retention funds, and it is clear that main contractors' retention funds are, in the main, an assemblage of sub-contractors' retentions which can present the following problems to the sub-contractor:-

  a) retention money withheld longer than contractual retention period
  b) retention money not returned in its entirety, or at all, often due to spurious claims against the fund
  c) main contractor insolvency
  d) main contractor under-valuation of project swelling retention funds

- As long ago as 1964 the Banwell Report recommended that retentions should go since they are out of place in a relationship based upon trust – the imposition of retentions indicates some distrust in the other party's ability to perform. The emphasis should be on ensuring that companies which carry out construction work are properly resourced and equipped to do the job (N.B. CLG's policy is that there should be system of company registration in the UK which gives clients comfort that they are engaging companies suitably equipped to carry out the required tasks).

- In "Constructing the Team", rather than outlawing retentions altogether, Sir Michael Latham recommended that if cash retentions were demanded, they should be kept in trust or, alternatively, retention bonds should be provided.

- The Government (as a best practice client) has taken up Sir Michael's recommendations and, invariably, retentions on Government projects will be in the form of bonds.

- Retention bonds offer the same protection as cash retentions. The trade associations which have registered agreements with the OFT stating that their members will not accept cash retentions are not increasing the risks to clients. In fact, a company which is able to offer retention bonds will have had its financial standing vetted by the bondsman and is therefore a safer bet for the client. Major clients in the private sector have recognised this and are happy to accept retention bonds eg. Boots and Natwest.

- Retention bonds are commonly in use in Europe and on international contracts. Clearly the use of a retention fund by a main contractor provides cash which can improve their own cash flow. If the main contractor is unable to provide a retention bond for the client, a negative cash flow exists if sub-contractors operate a retention bond system. There is a view that some main contractors continue to use retention funds as a method of generating cash, albeit a small amount.

- It has been argued by some that the adoption of OFT registered agreements in favour of using retention bonds, amounts to a significant restriction on competition. This is not the case, as it provides the same degree of retention security and could even be seen to enhance it. Financial benefits for clients are main contractors are also possible by adopting this practice.

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- Sub-contractors, trade contractors and specialist contractors of quality are able to provide substantial security to main contractors and, ultimately, to clients for the work that they carry out. These can be in the form of Retention Bonds; Performance Bonds; Parent Company Guarantees; other warranties, yet the two most obvious, non-contentious and acceptable methods of security are:

  a) accurate and detailed vetting of the proposed sub-trade or specialist contractor, and
  b) contractual conditions which legitimately allow payment in arrears for work carried out.

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