The Argument for Project Bank Accounts

What is a Project Bank Account?

A project bank account (PBA) is a ring fenced bank account set up to directly pay suppliers, throughout the supply chain, on a construction project. The client and the main contractor are generally the trustees of the account and control the movement of monies. The beneficiaries of the account are those suppliers who are working on a specific project. A PBA enables all suppliers to be paid at the same time and within the same timescales, without changing any traditional contractual responsibilities.

Why Use a Project Bank Account?

A PBA is used to manage risks that a construction client is exposed to and has the added advantage of promoting collaboration within a project to the benefit of the client:

- At a time when even the largest main contractors can become insolvent, a PBA protects a construction client from non-payment of suppliers on a project. In the event of lead contractor insolvency suppliers can be paid out of the PBA, thus reducing disruption to clients through suspension or termination of supply chain contracts within their project.
- A PBA has been shown to reduce costs within the supply chain by up to 2.5% as there is surety of payment and lower financing charges. These savings can be passed to the client during procurement. Government believe that these savings will be increased through greater productivity and a decrease in payment disputes.

There are other advantages to the project that a PBA will create, which accrue to the project and which will ultimately benefit the client. These include:

- Suppliers are more confident that they will be paid as insolvency risks are reduced: this encourages suppliers to bid for a project.
- An efficient, transparent payment process allows easier management of cash throughout the supply chain which reduces costs for project team members.
- A promptly paid supply chain is generally a collaborative one that will work together to resolve the inevitable issues that arise on a project.

- A PBA levels the power structure between a main contractor and generally smaller suppliers. Monies due to the supply chain cannot be paid to the main contractor (without client knowledge), which removes a main contractor's ability to manage its supply chain through cash management.

Who uses a Project Bank Account?

There are many organisations who have chosen to use PBAs to reduce their commercial risks and to promote the benefits of collaboration on their projects. These include:

- By 2020 Highways England will have paid over £20bn of infrastructure works to consultants and contractors through PBAs.
- The Scottish, Welsh and Northern Ireland Governments, who have mandated their use on all projects over £2M. (£4M in the case of Scotland.)
- The Queensland Government has followed other Australian states and mandated PBAs for public sector projects over £640,000. This will extend to the private sector from 2019.

Are there any Challenges?

There are a small number of challenges to overcome in setting up a PBA. These may include:

- Main contractor resistance, as many rely on the positive cash flow from contracts to fund their businesses. A PBA removes this source of funding.
- Setting up and operating the PBA requires some resource. If the client is to be a trustee to the account then the monthly payments need to be checked and authorised. (This may be less burdensome on clients than having to resource regular monitoring of main contractor payment performance.)

Conclusion

Large UK construction companies are heavily under-capitalised, which increases the risk of insolvency to clients. A PBA can reduce the risk of disruption to projects that inevitably follows the insolvency of a lead contractor. As payment periods continue to be extended the financial pressure that tier two and three suppliers are under increases; a PBA can support their engagement in a project, through greater surety of payment, thus increasing the benefits of collaboration. Given the industry's financial structure a PBA represents good value and wise risk management.

Notes for Implementing a Project Bank Account

Setting up a Project Bank Account

Government advice on PBAs can be found from the Cabinet Office. It is included in their advice on fair payment within the construction industry. Advice on setting up a PBA can be found on the SEC website. The minimum size of order to warrant a PBA will depend upon the circumstances, the minimum supplier order size and the project period. Short duration projects may not warrant the costs of setting up a PBA.

The main forms of contract support the introduction of PBAs. It is important to note that a standard PBA does not change the contractual terms, liabilities or responsibilities under the contract.

The primary risk management approach is to set up a PBA to pay the tier two subcontractors only (ie. those companies contracted to the main contractor). This will protect the client in the event of a main contractor insolvency. However, additional benefits can accrue to the project by allowing tier three and four subcontractors to be paid through the PBA, as the client will be providing insolvency protection further down the supply chain and creating an environment to encourage collaboration.

Background Parameters

The construction industry is fragmented with long supply chains. This allows the industry to provide an economic and highly tailored customer service, but does introduce tension at each interface between each successive tier within the supply chain. It is not uncommon to find up to five tiers of supply chain on a project, placing the lower tiers at financial risk of delays and insolvencies at any point further up the chain. Government statistics show that the highest number of insolvencies happen within the construction sector (excl. bulk insolvencies) and a PBA is designed to protect both the client and the other supply chain partners from the risk of insolvency.

Whilst pay when paid has been outlawed (other than in the case of insolvency) the consequences of late payment are easily recognisable. Payments from the ultimate client must work their way through the supply chain once paid in arrears to the Tier One contractor. Every supplier must fund the period from performing their task to being paid. This will cost in terms of an interest rate and fixed cost to mobilise funds. There is also an opportunity cost of lost benefits while these funds are outstanding. As the whole industry operates in arrears the opportunity cost to the ultimate clients is significant in terms of lost productivity and innovation.