

# Managing Financial Risk in Construction Projects

Recent market conditions, including increased insolvency risk and supply chain pressures, have led to greater use of financial protection measures on construction projects.

Vesting certificates, advance payment bonds and ABI guarantee bonds each serve different functions. This resource outlines what they are, when they are used and key points to consider when negotiating or reviewing terms.

## VESTING CERTIFICATES

### What is a vesting certificate?

A vesting certificate is a document confirming the transfer of ownership of specific goods, plant or materials from a contractor or supplier to the employer before those items are delivered to site. It evidences that title has vested in the employer.

### Why are they used?

They are primarily used where advance payments are made for off-site goods. They:

- Reduce the risk of loss if a contractor becomes insolvent before delivery
- Assist in addressing third-party retention of title claims
- Provide confirmation that goods are identified, stored and insured.

Vesting certificates have become increasingly common in recent years, reflecting insolvency risk and supply chain challenges.

It is important that vesting certificates are properly drafted and clearly identify the relevant goods.

## ADVANCE PAYMENT BONDS

### What is an advance payment bond?

An advance payment bond (sometimes called an advance payment guarantee) is a security instrument provided by a bank or insurer on behalf of a contractor. It guarantees repayment of an advance payment if the contractor fails to fulfil its obligations.

If the contractor defaults or becomes insolvent, the surety pays the guaranteed amount, usually equal to the advance payment.

### When are they used?

They are commonly used where:

- The employer makes an upfront payment for long-lead items or specialist equipment; or
- The contractor requires early funding to mobilise resources or secure materials.

## Nature of the bond

Advance payments bond may be:

- **On-demand** - allowing payment upon written demand; or
- **Conditional** - triggered by specified events such as insolvency or failure to perform.

The surety will charge a fee based on factors such as bond type, duration, amount and contractor risk profile.

Step-down provisions are often negotiated so that the bond amount reduces as delivery progresses.

### Common issues to consider:

- Demand wording
- Alignment with the main contract
- Expiry dates and coverage periods
- Surety financial standing
- Cost implications

Clear drafting and consistency with the underlying contract are important.

## ABI GUARANTEE BONDS

### What is the ABI Model Form of Guarantee Bond?

The ABI (Association of British Insurers) Model Form of Guarantee Bond is a standardised default performance bond used in construction contracts. It typically provides financial protection up to a specified cap, often around 10% of the contract sum.

Unlike an on-demand bond, it requires breach to be established before payment is made.

### Why can issues arise?

In its unamended form:

- The employer must establish breach and quantify loss before recovery.
- Recovery may require adjunction, litigation or arbitration.
- Contractor insolvency is not automatically treated as breach under some standard forms.
- The guarantor is not automatically bound by settlements or determinations under the contract.

This can make enforcement more complex depending on the circumstances.

## Amendments often considered

Targeted amendments may include:

- Expressly treating contractor insolvency as a breach
- Removing “finally established” requirements
- Permitting assignment without guarantor consent
- Binding the guarantor to contractual settlements and determinations

It is good practice to review the bond terms alongside the underlying contract.

## HOW CAPSTICKS CAN HELP

Our construction team advises clients across public and private sector projects on the drafting and negotiation of vesting certificates and security instruments.

We can assist with:

- Reviewing and amending vesting certificates
- Advising on advance payment bond structures
- Negotiating amendments to ABI guarantee bonds
- Ensuring consistency between bonds and the main contract



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