

Research on Issues in the Realization of Floating Mortgage

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Abstract

This paper examines key issues in the realization of floating mortgage under Chinese civil and commercial law. Through an empirical analysis of 72 typical judicial decisions, three core practical problems are identified: 1) judicial dilemmas concerning the scope of fructus within the mortgaged property; 2) ambiguous legal boundaries for the exercise of the right of intervention by the mortgagee as a property-fixation event; and 3) inconsistent judicial standards for the “reasonable identification” of general descriptions of mortgaged assets. The study argues that the scope of floating mortgaged property should be moderately expanded by extending the concept of “proceeds” to include fruits and intangible assets through purposive interpretation. Regarding property fixation, the mortgagee’s right of intervention should be recognized as a legitimate “other circumstance seriously affecting the realization of the claim” only when it constitutes a necessary measure to preserve the mortgaged property. Concerning general descriptions, a dual standard is proposed: a strict general reasonable identification standard and a flexible special reasonable identification standard allowing judicial discretion based on trade customs, party autonomy, and legislative spirit. The findings provide a systematic framework for improving the legal application of floating mortgage realization.

Keywords

Floating Mortgage; Realization of Mortgage; Property Scope; General Description; Property Fixation

1. Introduction

With the development of the socialist market economy, the floating mortgage system has gained increasing application in civil and commercial activities. According to an empirical search on China Judgments Online, from 2021 to the present, a total of 474 civil cases involving the floating mortgage system have been adjudicated. Existing research on floating mortgage in China has mainly focused on theoretical deficiencies and legislative improvements, while relatively few studies have examined the application of the law since the enactment of the Civil Code in 2021. In judicial practice, issues concerning the scope of mortgaged property, the

determination of property-fixation events, and the standards for establishing a floating mortgage remain urgent problems. This paper analyzes 72 typical judgments and proposes systematic improvements to the applicable rules for the realization of floating mortgage.

2. Judicial Practice and Core Issues

2.1. Controversy over the Scope of the Mortgaged Object

Article 396 of the Chinese Civil Code limits the scope of floating mortgaged property to four categories: production equipment, raw materials, semi-finished products, and finished products. Current legislation adopts the view that “the object of real right does not need to be specific from the beginning, only at the time of enforcement” [1]. This formalistic enumeration restricts the functional efficiency of the system. Compared with traditional floating mortgage, the scope has become extremely narrow, and the function of the floating mortgage is greatly suppressed [2]. Overall, the formal enumeration of property types in current legislation objectively constrains the institutional efficacy [3]. In the sample cases, two main disputes emerged:

- 1) Biological assets and their fruits: In case (2022) Yue 0391 Min Chu No. 3931, the court was faced with whether newborn piglets (natural fruits of breeding sows) should be included. Although no direct response was given, a tendency toward functional expansion of the concept of “proceeds” was observed.
- 2) Intangible property: In case (2023) Yue 0604 Min Chu No. 11414, the court limited the mortgaged property to “existing and future raw materials and semi-finished products in the plant,” excluding intellectual property rights.
- 3) Commingled movable property: In case (2021) Gui Min Shen No. 6826, the commingling of molasses products led to difficulties in identifying the specific mortgaged property after fixation. Table 1 below summarizes the judicial approaches.

Table 1. Typological analysis of judicial determination of floating mortgage object

<i>Type of case</i>	<i>Judicial tendency</i>	<i>Typical case number</i>
Biological assets and their fruits	Limited expansion	(2022) Yue 0391 Min Chu No. 3931
Intangible property rights	Strict restriction	(2023) Yue 0604 Min Chu No. 11414
Commingled movable property	Case-by-case balancing	(2021) Gui Min Shen No. 6826

(based on 72 samples)

2.2. Divergent Determination of Property-Fixation Events

Article 411 of the Civil Code lists four events that cause the floating mortgage property to crystallize: 1) expiry of the debt performance period with unsatisfied claim; 2) bankruptcy or dissolution of the mortgagor; 3) occurrence of an agreed crystallization event; and 4) other circumstances seriously affecting the realization of the claim. In the 72 sampled cases, the distribution of these events is shown in

Table 2.

Table 2. Judicial application ratio of property-fixation events

<i>Property-fixation event</i>	<i>Proportion in samples</i>	<i>Typical case number</i>
Expiry of debt period	58%	(2022) Xiang 07 Min Zhong No. 1153
Bankruptcy or dissolution of mortgagor	8%	(2022) Yun 29 Min Chu No. 466
Agreed crystallization event	19%	(2022) Hei 12 Min Zhong No. 1603
Other circumstances seriously affecting the claim	15%	(2021) Zhe 02 Min Chu No. 1250

(based on 72 samples)

A particular dispute concerns the right of intervention. In case (2023) Yu 16 Min Zhong No. 208, the mortgagee detained the vehicle's certificate of conformity to prevent disposal of the mortgaged vehicle. The first instance court denied the legal effect of property fixation, while the appellate court affirmed it, recognizing the mortgagee's right of intervention as a legitimate means to preserve the mortgaged property.

2.3. Inconsistent Standards for Establishment of the Mortgage

The standard for general description of floating mortgaged property directly affects whether the mortgage can be judicially supported. According to Article 53 of the Judicial Interpretation of the Civil Code on Security Interests, a general description is valid only if it "reasonably identifies" the secured property. In practice, two types of defects frequently lead to denial of the mortgage:

- 1)Vague description causing invalidity: In case (2023) Zui Gao Fa Min Shen No. 2261, the phrase "all movable property" was held insufficient to identify specific assets. In case (2022) Yue 0304 Min Chu No. 30423, the description "37,348 units of Midea products existing and future" was also found lacking in specificity.
- 2)Limited supplementary role of trade customs: Few courts rely on trade customs to interpret general descriptions, leaving many reasonable security arrangements invalidated. Table 3 shows the correlation between defect types and outcomes.

Table 3. Correlation between types of defects in general description and judicial outcomes

<i>Type of defect</i>	<i>Judicial outcome</i>	<i>Typical case number</i>	<i>Sample proportion</i>
Vague description of category	Mortgage not established	(2022) Yun 29 Min Chu No. 466	62%
Quantity not specified	Partially supported or dismissed	(2022) Yue 0304 Min Chu No. 30423	28%
Mixed description and publicity defect	Absolutely void	(2022) Yun 0126 Min Chu No. 2264	10%

(based on 72 samples)

3. Analysis of Prominent Problems

3.1. Judicial Dilemma Concerning the Scope of Fructus

The difficulty in determining whether natural fruits (e.g., newborn livestock, crop

yields) fall within the floating mortgage arises from two causes: (1) Article 412 of the Civil Code limits the right to collect fruits to the period “after seizure,” which conflicts with the dynamic nature of floating mortgage; and (2) current legal application follows formal enumeration rather than functional interpretation of “proceeds.” Some scholars argue that “price” in Article 406(2) should be purposively expanded to “proceeds,” enabling subrogation, and that proceeds from the transfer of mortgaged movable property may include fruits, proceeds from sale, and claims after damage or loss [4]. Under current law, before the floating mortgaged property enters judicial seizure, the mortgagor has the right to dispose of fruits in the ordinary course of business, and fruits may be excluded from the final secured property by lawful disposal [5]. However, under the principle of consensus, courts should consider the objective circumstances of the parties’ contract. The existing preconditions for the creation of a security interest in movable property under current law provide an institutional basis for the implied extension of security interests in movable property [6]. This paper argues that the purpose of the security system, the reasonable expectations of the parties, and the measurable nature of natural fruits all support extending the mortgage’s effect to fruits. Comparative law generally recognizes that security interests automatically extend to proceeds and fruits to maintain the economic integrity of the secured asset.

3.2. Ambiguous Legal Boundaries for the Right of Intervention

The right of intervention (i.e., the mortgagee taking physical control of the mortgaged assets to prevent their dissipation) is not explicitly regulated in Chinese legislation. The key question is whether such intervention constitutes a “necessary measure” to preserve the mortgage or an “excessive interference” with the mortgagor’s business operations. In case (2023) Yu 16 Min Zhong No. 208, the first instance and appellate courts reached opposite conclusions on this issue. The exercise of the right of intervention by the mortgagee must not conflict with the bona fide purchaser rule in ordinary course of business [7]. In principle, the mortgagee should not interfere with the value of the mortgaged property during the ordinary course of business [8]. However, when the value of the mortgaged property is seriously diminished and continues until the point of fixation, the realization of the security will be severely affected. Although Article 406 of the Civil Code provides that the mortgagee has a right of pursuit when the mortgaged property is transferred, the effect of a floating mortgage before crystallization cannot defeat the mortgagor’s right of disposal in the ordinary course of business. Therefore, it is necessary to restrict the mortgagor’s conduct through negative pledge clauses to “prevent others from obtaining priority over the floating mortgage” [2]. The current Civil Code has not established a special remedy for such situations, so recognizing the necessity of the mortgagee’s right of intervention to preserve the mortgaged property, within certain limits, can

constitute a dynamic balance of interests and ensure the effective realization of the floating mortgage [9].

3.3. Fragmented Judicial Standards for General Description

The lack of clear legislative criteria for “reasonable identification” leads to excessive judicial discretion and inconsistent outcomes. Under the floating mortgage system, due to the fluid nature of the mortgaged property, a general description must be used to define the scope of the property. The principle of specificity requires that the object of real right be certain; however, if a general description meets the “reasonable identification” standard, specificity can be achieved through a dynamic definition of the property scope, thereby balancing the interests of the mortgagor and third parties [10]. A dual-tier standard is necessary:

- 1) General reasonable identification standard. The description must at least specify the type, name, and quantity of the property, as implied by Article 400 of the Civil Code. Vague phrases like “all property” do not satisfy this standard.
- 2) Special reasonable identification standard. Where the description, though not meeting the general standard, can be reasonably interpreted by reference to trade customs, party autonomy, legislative purpose, or case-specific circumstances, courts may exercise discretion to uphold the security interest. This approach balances the need for certainty with the functional goal of facilitating secured credit.

4. Improvement of Applicable Rules

4.1. Clarifying the Scope of Floating Mortgaged Property

The provisions of the Chinese Civil Code on the scope of movable floating mortgage property are relatively rigid, which objectively restricts the use efficiency and circulation value of the floating mortgaged property, weakens the practical advantages of the system, and may lead to a reduction in the encumbered property. Mortgagors may use this provision to evade their secured debt [11]. Therefore, it is necessary to moderately expand the scope of mortgaged property. Courts should not rigidly adhere to the formal list of property types in Article 396. Instead, a functional approach should be adopted, using the “reasonable identification” standard as a baseline. Through purposive interpretation, the concept of “proceeds” in the Civil Code’s property rights section is open-ended and internally consistent with the purposes of security law. Modern legal theory has expanded “proceeds” beyond traditional “use-benefit” to include value increases from asset circulation and intangible assets. Therefore, purposive expansion can be employed to include natural fruits and certain intangible assets (e.g., receivables, intellectual property licenses) within the scope of floating mortgaged property, subject to identifiability and public notice requirements. The scope of floating mortgaged property can be comprehensively determined based on the identifiability of proceeds, the continuity of publicity, and other factors [12].

4.2. Standardizing the Determination of Property-Fixation Event

General rule: Courts shall determine that the floating mortgaged property has crystallized upon the occurrence of any of the four statutory events under Article 411.

Special rule concerning the right of intervention: The mortgagee's intervention should be recognized as a crystallization event only if it meets the necessity test. In case of the mortgagor's malicious disposal and urgency, the intervention may be justified as "other circumstances seriously affecting the realization of the claim". Conversely, if the intervention severely restricts the mortgagor's ordinary business operations (e.g., complete control over transaction counterparties and funds) to an extreme degree such that the purpose of the floating mortgage is completely lost, it should not be recognized as a fixation event [13]. Based on the principle of interest balancing, the exercise of the mortgagee's right of intervention should be subject to necessary restrictions, and the realization of the floating mortgage can be better protected by strengthening supervision over the debtor's conduct [14].

4.3. Unifying the Judicial Standard for General Description

The judicial interpretation of Article 53 should distinguish two scenarios:

General reasonable identification standard: As a minimum, the description must include the type, name, and quantity of the property. A description such as "all property" without further specification fails this standard, and the security interest shall not be established.

Special reasonable identification standard: Courts may exercise discretion, considering trade customs, party intent, legislative purpose (facilitating financing), and case-specific factors. For example, where property of the same type but different values is described as "one of the two," the special standard may be applied, taking into account the value of the relevant property and the overall financing context. This approach, based on a dynamic systems methodology, ensures reasonable judicial discretion while gradually building binding case guidance.

5. Conclusion

Establishing a scientific and reasonable mechanism for the realization of floating mortgage can effectively promote enterprise financing and protect the security rights of creditors. In current judicial practice, extending the scope of floating mortgaged property to fruits has sufficient legislative, theoretical, and practical justification. Courts may appropriately introduce the "value-extension theory," treating fruits as a natural extension of the original property's security effect. Regarding the right of intervention, a case-by-case necessity assessment should determine whether it qualifies as a crystallization event. For general descriptions, a dual standard (general and special reasonable identification) should be established through judicial interpretation. The People's Courts Case Database, which contains

guiding and reference cases, should be expanded with more precedents on floating mortgage to provide clearer guidance for legal application.

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