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Research on the Reconstruction of the Regulatory System for Pre-Sale Funds of Commodity Housing

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Abstract: In recent years, China has witnessed frequent incidents of “unfinished buildings” resulting from regulatory failures in pre-sale funds under the commercial housing pre-sale system. These incidents have severely compromised consumers’ rights and interests, even posing threats to financial security. Against this backdrop, this paper focuses on the systematic reconstruction of the pre-sale funds supervision framework for commercial housing. Within the context of preserving the pre-sale system, we propose an enhanced approach centered on bank-led supervision with multi-stakeholder collaboration. This approach emphasizes establishing banks as the core regulatory entities, leveraging their professional risk control capabilities to implement efficient oversight through dedicated closed-loop accounts, credit assessments, and dynamically linking fund disbursements with construction progress. Concurrently, we advocate establishing a pre-sale permit mechanism mandating bank supervision as a prerequisite, engaging professional institutions (e.g. law firms and accounting firms) for collaborative oversight, enhancing public risk awareness education, and utilizing incentive mechanisms with market elimination mechanisms to promote developers’ standardized operations. This comprehensive suite of measures aims to safeguard consumers’ interests, regulate the pre-sale market order, and foster the healthy development of the real estate market.

Keywords: Pre-sale of commercial housing, Pre-sale funds supervision, Bank risk control, Reconstruction of regulatory system

1. Introduction

The commercial housing pre-sale system, established under China’s Urban Real Estate Administration Law in 1994, has played a pivotal role in accelerating housing supply and advancing urbanization. However, as market supply-demand dynamics undergo profound transformations, vulnerabilities within its fund supervision framework have become increasingly pronounced [1]. Developers’ misappropriation of pre-sale funds has resulted in phenomena such as "unfinished buildings," severely infringing upon consumers’ legitimate rights and interests, and even threatening financial security and social stability [2-3]. Consequently, institutional reconstruction has become imperative. Current academic discourse presents two divergent pathways: the "abolitionist approach" and the "reformist approach." [4] The former advocates complete elimination of the pre-sale system in favor of completed-property sales, yet neglects the real estate sector’s extended

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industrial chain characteristics. Abrupt abolition would trigger developer liquidity crises, generate ripple effects across upstream and downstream industries, precipitate systemic financial risks, and ultimately intensify housing price pressures in regions with supply-demand imbalances [5-6]. The latter approach, grounded in optimizing the existing institutional framework, demonstrates greater practical feasibility. This paper adopts the reformist perspective, focusing specifically on reconstructing the commercial housing pre-sale funds supervision system. Its central research objective is to systematically conceptualize and design a novel regulatory framework positioning banks as the core supervisory entities with multi-institutional collaboration. Methodologically, the study employs normative analysis and comparative research. On the one hand, it conducts an in-depth analysis of deficiencies in China's current legal regulations and practical regulatory challenges to identify institutional loopholes and risk exposures. On the other hand, it draws upon effective regulatory experiences from Germany, Singapore, and Hong Kong to develop contextually adapted, targeted, and implementable institutional redesign proposals. The significance of this research lies in establishing a bank risk control-centered, multi-stakeholder collaborative supervision system. This framework aims to prevent fund misappropriation at its institutional source, safeguard consumer interests and market stability, and provide actionable pathways for mitigating systemic risks within the real estate sector.

2. Institutional foundations for centralizing bank supervision

The rationale for reforming the commercial housing pre-sale system rests upon three pillars: its operational necessity, the inherent limitations of current regulatory models, and the unique suitability of banks as core supervisory entities. Comprehensive abolition of the pre-sale system proves infeasible when considering the interconnectedness of real estate capital chains, industrial linkages, and financial system stability. Consequently, reconstructing its core funds supervision framework while preserving the pre-sale system's foundational structure presents the most viable approach. Within pre-sale transactions, developers—as profit-driven market entities—inherently face moral hazard risks during project execution and fund utilization. Practically, developers frequently exploit their informational and financial advantages to divert pre-sale funds for unauthorized purposes or engage in misleading marketing claims. Although governments bear responsibility for safeguarding public interests, their regulatory efficacy faces dual constraints. The first one is technical limitations. Regulatory agencies inherently lack specialized capabilities for precise financial risk assessment and dynamic monitoring of developers' complex fund flows. Furthermore, factors like local protectionism may compromise regulatory impartiality and effectiveness. Therefore, identifying entities with high credibility and professional competence to assume supervisory responsibilities becomes imperative for systemic improvement [7].

Banks possess distinctive advantages as financial institutions in fund supervision. First of all, banks are equipped with professional financial risk assessment teams and comprehensive risk control frameworks. These mechanisms enable systematic and in-depth evaluations of developers' financial conditions, operational capabilities, and credit histories. This facilitates the accurate identification of potential risk factors at an early stage and allows for the implementation of timely and effective preventive and mitigation measures. Secondly, the bank has accumulated rich experience in the field of fund circulation and possesses efficient operational capabilities. It can precisely and promptly disburse funds based on the actual construction situation of the project and the progress of the engineering, effectively ensuring the smooth progress of the project construction. Furthermore, the credit rating system of banks provides an effective credit enhancement mechanism for developers, motivating them to attach importance to their own credit building, actively fulfill

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contractual obligations, complete project construction on schedule and deliver houses, thereby achieving effective risk mitigation [8]. In conclusion, reconstructing the pre-sale funds supervision system with banks as central regulatory actors constitutes not merely a pragmatic response to current institutional shortcomings, but a fundamental pathway toward stabilizing real estate markets and protecting consumer rights.

3. Pathway for bank-led regulatory system design

3.1. Dedicated account management and credit assessment mechanisms

Mandatory closed-loop management of dedicated accounts achieves physical segregation and earmarked use of pre-sale funds through legal means. Although The Urban Commercial Housing Pre-Sale Administration Measures require depositing pre-sale funds into supervised accounts, decentralized implementation under localized policies (“one-city-one-policy”) has led to nominal supervision accounts and fund misappropriation in some regions. Hong Kong safeguards 95% of down payments through solicitor trust accounts—effectively isolating funds but demanding professional capabilities difficult to replicate in the mainland [9]. Therefore, we propose strengthening the "one-permit-one-account" framework under bank supervision, prohibiting collections via non-supervised accounts, and amending The Commercial Bank Law to impose penalties for unauthorized fund transfers. Two critical tensions must be resolved. Firstly, there is a conflict between fund security and efficiency. We can draw on the experience of Germany to refine the allocation nodes and proportions, establish a fast approval channel, and introduce a third-party assessment. Moreover, there is a conflict of interest between banks and developers. This can be addressed by using blockchain technology to record the flow of funds, conducting third-party audits and spot checks, and enhancing transparency. Additionally, implement a dynamic credit assessment system to quantify developer risk, aligning fund disbursements with credit tiers. China’s current locally administered credit ratings lack standardized criteria and independence. We recommend establishing a nationally unified framework led by the central bank with CBIRC coordination, integrating outcomes with pre-sale permits and financing costs. This system should adopt a “basic credit score + dynamic adjustment coefficient” model, incorporating project-specific factors (e.g., location) for flexibility. Furthermore, introduce a bank guarantee mechanism allowing highly rated developers to substitute portions of supervised funds, thereby mitigating liquidity pressures.

3.2. Dynamic binding of project progress and fund disbursement

The legal basis for node-based disbursement stems from the “special funds for special purposes” principle stipulated in the Urban Commercial Housing Pre-sale Management Measures. Through key nodes such as foundation completion, topping out, and completion, the funds are tied to the disbursement process, aiming to prevent the risk of fund misappropriation. However, the current model faces two major drawbacks. Firstly, the standards are fragmented. For instance, Xi'an requires 70% of the funds to be disbursed after the main structure is topped out, while Wuhan only allows 50%. Regional differences create opportunities for arbitrage. Secondly, the review process is formalistic. The collusion between banks and enterprises in falsely reporting progress leads to the premature release of funds, exacerbating the risk of unfinished projects [10]. In this regard, we can draw on the experience of flexible allocation in Germany and establish a "basic node + dynamic adjustment" mechanism. That is, through legislation, mandatory minimum allocation ratios for core nodes such as the foundation and the ceiling should be stipulated. For example, after the ceiling is

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reached, the ratio should be above 50%. The provincial departments are authorized to adjust the ratios of secondary nodes, such as decoration, based on economic differences, and a developer's objection and appeal procedure should be added to balance the safety of funds and the liquidity of the project. Furthermore, the “Contract signing-Supervision-Project implementation" integrated platform that integrates data from housing construction, banks, and tax authorities can link the allocation of funds with the project progress in real time, thereby enhancing the regulatory efficiency. However, it faces challenges such as the reliance on administrative verification for data authenticity and the risk of data tampering due to platform security vulnerabilities. The Singapore experience shows that requiring developers to upload project images and having them cross-verified by a third party can strengthen the credibility of the data [11]. Therefore, it is suggested that in the revision of the Commercial Bank Law, China should add a “cross-validation of project progress” clause. This clause would require banks to independently verify the progress using technologies such as drone aerial photography and blockchain evidence storage, and the verification results would be used as a prerequisite for disbursement. Meanwhile, a unified national technical standard should be established, and financial subsidies should be provided to small and medium-sized banks to bridge the technological gap and ensure the safe operation of the platform.

3.3. Liability enforcement and risk-sharing mechanisms

3.3.1. Strengthening accountability for bank regulatory violations

Strengthening accountability mechanisms for bank regulatory violations requires establishing legal liabilities commensurate with their supervisory authority. For instance, mandating that banks bear advance compensation liability at a fixed percentage of improperly supervised funds when prudential oversight failures enable misappropriation—coupled with suspension or revocation of supervisory qualifications—would compel banks to enhance risk controls and rigorous verification, thereby fostering sound competition within the industry. Firstly, there are technical difficulties in determining liability. Banks often argue that developers fabricated the materials. The means for defining the authenticity of the funds' use and the oversight in the review process need to be improved. Secondly, there is a difference in risk tolerance. Small and medium-sized banks may fall into a liquidity crisis due to large compensation payouts. Thirdly, there is the risk of overly conservative regulation. Excessive liability may delay reasonable allocation and affect the project’s progress. In response to this, it is suggested to establish a special compensation reserve system, calculate it based on the scale of regulatory funds, and implement graded penalties. Set differentiated standards according to the severity of violations, while clearly defining the boundaries of banks' prudent review obligations and improving the rules for determining responsibilities.

3.3.2. Innovation of risk mitigation tools

In the innovation of risk mitigation tools led by banks, the bank guarantee system is a significant breakthrough. According to the Notice on the Work Related to the Issuance of Bank Guarantees by Commercial Banks to Replace Supervised Funds for Pre-sale issued by China in 2022, high-quality developers can replace part of the supervised funds with bank guarantees, optimizing the allocation of funds, and banks can also expand their intermediary business. However, three major risks need to be vigilant about, including lax review of the authenticity of guarantees, concentrated credit risk outbreak of banks, and delayed protection of consumers’ rights and interests [12]. Therefore, the guarantee amount should be dynamically linked to the project progress to ensure that the replaced

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funds match the completed work volume. At the same time, an upper limit should be set for the guarantee amount of a single project to disperse the risk exposure. In addition, an automatic circuit breaker mechanism should be introduced to freeze or recover the replaced funds for developers who fail to reach key nodes, and a trusted platform should be built with blockchain technology to enhance information transparency and verification efficiency.

3.3.3. Balance of regulatory powers and responsibility undertaking

The current legislation has the problem of "strong authorization but weak accountability."For instance, relevant laws and regulations do not clearly define the liability for dereliction of duty and the standards for senior executives' performance. This can easily lead to an imbalance of power and responsibility. Specifically, it manifests as fragmented regulatory powers, a mismatch between form-based review and substantive risks, and the virtual absence of accountability under conflicts of interest [13]. This article suggests reconfiguring the unified system of power and responsibility from three aspects: legislatively, revise the "Commercial Bank Law", add a special chapter on pre-sale fund supervision, establish the principle of fault presumption, that is, presume the bank's negligence unless it proves that it has fulfilled the obligation of a "reasonable and prudent person", and set up a hierarchical responsibility standard. Technically, build a unified national information platform and force banks to access data from multiple departments to provide an objective basis for responsibility determination. Mechanically, establish a "bank-insurance-fund" tripartite system, through liability insurance, shared funds, and participation of home buyers in decision-making, to alleviate the burden of bank responsibility. At the same time, be vigilant against the regulation alienation caused by technological dependence, avoid the increase of financing costs due to joint liability, and set responsibilities differently based on the size of the bank to achieve the balance of power and responsibility and the balance of financial innovation.

4. Construction of the supporting regulatory system

To ensure the effectiveness of banks as the core entities responsible for supervising pre-sale funds, a comprehensive supporting regulatory system must be established [14]. Firstly, it is crucial for banks to entrust professional institutions to assist in supervision. Real estate projects are complex and involve large volumes of funds, making it difficult for banks to monitor all details on their own. By introducing law firms, legal opinions can be provided regarding the legality of fund usage and the compliance of contracts, thereby preventing legal risks. Meanwhile, accounting firms can track the flow of funds through professional audits, ensuring that the funds are exclusively used for the project and preventing misappropriation, thus safeguarding the rights and interests of consumers. The participation of professional institutions enhances the scientificity, effectiveness and credibility of supervision. Their independent and objective audit reports and legal opinions boost the confidence of consumers, and at the same time, expand the business scope of professional institutions, achieving a win-win situation for all parties. Furthermore, enhancing public education on laws and risk awareness is a fundamental step in safeguarding the rights of home buyers. In reality, home buyers often focus on the properties themselves while neglecting the professional risks of fund supervision, providing opportunities for unscrupulous developers. It is necessary to conduct extensive and continuous legal education campaigns, such as community lectures, media publicity, and online platforms, combined with case analyses, to enable the public to deeply understand the potential risks of pre-sale projects without bank supervision, which may lead to "no money and no house" situations. The property promotion work should focus on targeting. For instance, prepare

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simple materials for first-time home buyers and organize in-depth lectures for those with experience. At the same time, it is also necessary to pay attention to sustainability, continuously update and disseminate the latest regulations and policies, and enhance the risk identification and prevention capabilities of home buyers. Finally, establish a positive and negative incentive mechanism and a market elimination mechanism to guide developers to behave in a compliant manner. Positive incentives encourage developers to choose the legal path. Stronger developers can opt for on-site sales to avoid regulatory risks or choose the bank-supervised pre-sale model to leverage the bank's credit endorsement to enhance competitiveness and expand market share. The government can reduce the costs of compliant developers through measures such as lowering land transfer fees, extending payment periods, simplifying approval processes, and providing preferential loan interest rates from banks. Reverse incentives, on the other hand, impose severe penalties for violations. For developers who illegally pre-sell properties, the government should revoke their pre-sale licenses, confiscate illegal proceeds, and impose heavy fines. Banks can blacklist such developers and restrict their financing, significantly increasing the cost of violations. At the same time, the market mechanism plays a crucial role. As consumers' risk awareness increases, projects lacking bank supervision will struggle to sell due to the lack of market trust and will eventually be eliminated by the market. This mechanism prompts the market to self-optimize, eliminating developers with weak capabilities and poor management and improving the overall quality level of the industry.

5. Conclusion

The reform of the supervision system for pre-sale funds of commercial housing is a crucial issue concerning people's livelihood and financial security. This paper systematically explores the necessity of the reform of the pre-sale fund supervision system and proposes an improved path centered on bank supervision and involving multiple stakeholders. The research conclusions of this paper indicate that the restructured supervision system helps to balance risk prevention and market stability, and to some extent, solves problems such as the lack of uniformity in current fund supervision standards, insufficient bank supervision motivation, developers' moral risks, and the deficiency of government supervision accuracy. By introducing innovative mechanisms such as bank guarantees, credit ratings, and linking financing costs, it can not only motivate developers to operate in a standardized manner but also provide rights protection for consumers, promoting the healthy development of the real estate market. However, this research still has areas for improvement. For example, in terms of the determination of bank liability for violations, this paper does not specifically elaborate on how to define situations where banks fail to fulfill prudent supervision obligations, nor does it deeply discuss how to balance bank responsibility and risk tolerance, as well as how to better coordinate the interests and responsibilities of all parties in the multi-stakeholder supervision. These aspects are worthy of further in-depth research. Future research can focus on the empirical analysis of pre-sale fund supervision by collecting and analyzing a large amount of case data to verify the effectiveness of different supervision mechanisms in practice, as well as their impact on the real estate market, consumers' rights and interests, and financial stability, thereby providing more powerful support for policy formulation.

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