

Financial Supervision and Path Optimization in Hainan under the Background of Hainan Free Trade Port Construction

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Abstract: *Since the establishment of Hainan Province, from the establishment of special economic zones, to the construction of international tourism island, and then to the construction of Hainan free trade port, Hainan's financial industry has advanced in setbacks. The implementation of high-quality financial supervision is an important guarantee for the innovation and opening of the financial industry in Hainan Free Trade Port. At present, there are realistic difficulties in the financial development of Hainan Province, such as the imbalance between financial innovation and financial supervision, insufficient institutional setup and personnel, and imperfect legal protection of financial supervision. In the future, the financial supervision reform of Hainan Free Trade Port should further improve the local financial supervision and management system at the city and county levels, strengthen the rule of law construction in the field of local financial supervision, and optimize the responsibilities of local financial supervision departments.*

Keywords: *Hainan Free Trade Port; Local financial supervision; Regulatory sandbox*

1. Introduction

Hainan Province is China's largest special economic zone, largest pilot free trade zone and the only free trade port with Chinese characteristics. On April 13, 2018, the CPC Central Committee decided to support the construction of a pilot free trade zone on the whole island of Hainan, support Hainan to gradually explore and steadily promote the construction of a free trade port with Chinese characteristics, and establish a free trade port policy and system in steps and stages. On June 1, 2020, the *General Plan for the Construction of Hainan Free Trade Port* was officially released, making it clear that the implementation scope of Hainan Free Trade Port covers the whole island of Hainan. By 2025, we will initially establish a free trade port policy system focusing on free trade and investment facilitation. By 2035, it will become a new plateau for China's open economy and a high-level free trade port with strong global influence by the middle of this century.

After six years of layout and development, the construction of Hainan Free Trade Port has entered a key stage before closure. As an important part of the modern service industry, the number and scale of financial institutions in Hainan have expanded rapidly, and bold innovative attempts have been made in the fields of multi-functional free trade accounts, qualified overseas limited partner balance management, and qualified domestic limited partner overseas investment, providing important support for the high-quality development of Hainan's economy. However, on the whole, the development scale of Hainan's financial industry is still small, and there are still illegal fundraising, financial fraud and other regional overall risks are significantly increased. At the same time, with the advancement of the reform of the local financial supervision system, the local has become an important battlefield for the prevention and resolution of financial risks. In the background of the construction of Hainan Free Trade Port, what challenges are faced by the reform of Hainan's financial regulatory system and how to deal with them? This paper analyzes the shortcomings of Hainan's financial regulatory history and reform since the construction of Hainan free trade Port, and explores a more innovative and open financial regulatory system.

2. The historical process of Hainan's local financial supervision

Since the establishment of Hainan Province in 1988, under the strong leadership of the Party, the

social and economic development of Hainan has made great strides. The financial industry advances in setbacks and gradually plays an important supporting role in local economic construction. Financial development and supervision in Hainan Province has experienced five different stages of development:

2.1 1988-1992: The financial industry developed abnormally and financial supervision was not in place

In 1988, Hainan Province was established and special economic zones were set up, which made Hainan's financial industry a double opportunity of regional opening and industry reform. Driven by a series of preferential policies, Hainan's financial industry has made rapid development in the early days of the establishment of the province, becoming one of the regions with the most dense financial institutions, the most concentrated financial talents, a relatively loose financial operating environment and the most active financial business innovation. The innovation of Hainan's financial industry in the financial system, financial business, financial institutions and financial markets has carried out beneficial exploration for the national financial reform and development, and accumulated a lot of valuable experience.

Open finance has brought about vigorous development, but also put forward higher requirements for financial supervision. However, due to the limitations of many factors such as history, system, ideology and experience, the problems of unified single bank and lack of financial supervision need to be further explored and solved, and the risks contained in the extraordinary development of the financial industry did not attract enough attention from the financial supervision department at that time.

2.2 1993-1997: The outbreak of financial risks, the strengthening of financial supervision, rectification of financial order

With the bursting of the real estate bubble in Hainan, the normal operation of financial institutions has been greatly impacted, the pace of financial innovation has slowed down, the development of the financial industry has been heavy, and the development of the financial industry has experienced a severe test. Hainan has changed from a leading area in the development of the financial industry to a "financial high-risk area", and bad debts, bank runs, rectification, reorganization, rescue and closure have become the key words of Hainan's financial industry in this period.

In response to the outbreak of financial risks, the Hainan Branch of the People's Bank of China has taken effective measures to strengthen financial supervision and rectify financial order while strengthening the construction of institutional norms. *"The Interim Measures for the Supervision of Trust and Investment Companies in the Hainan Special Economic Zone"*, *"The Interim Measures for the Management of Hainan Pawn Industry"*, *"The Interim Measures for the Establishment and Business Supervision of Hainan Urban Credit Cooperatives"*, *"The Interim Regulations of Hainan Province for the Management of Mortgage Loans"*, *"The Interim Measures of Hainan Province for the Management of Enterprise Short-term Financing Bonds"*, *"the Interim Measures of Hainan Province for the Management of Real Estate Investment Bonds"*, have been formulated successively. And through the establishment and implementation of financial supervision leadership responsibility system, financial supervision quarterly reporting system, rapid reporting system of major financial risk cases, off-site supervision system of financial institutions, non-bank financial institutions legal representative and senior management talk system, financial institutions provision statement system and financial institutions legal person qualification review system, etc. It has improved the standardization and efficiency of financial supervision.

2.3 1998-2003: Financial reconstruction and reconstruction, financial supervision was strengthened and improved

In 1998, the Southeast Asian financial crisis broke out, and the financial situation at home and abroad was complicated and changeable. Financial institutions in Hainan Province generally lack liquidity, forming a large number of non-performing assets, small and medium-sized financial institutions face payment difficulties to a certain extent, trust and investment institutions have been closed for rectification, and most foreign financial institutions have withdrawn from the Hainan market. In addition, in November 2001, China formally joined the WTO, including Hainan, the domestic financial industry into the critical period of reform and opportunity.

During this period, the Hainan Branch of the Bank of China, the Hainan Banking Regulatory Bureau, the Hainan Securities Regulatory Bureau, and the Hainan Insurance Regulatory Bureau were set up, and the local financial regulatory pattern of "one line and three meetings" initially took shape. At the same time, the adjustment and reform of financial institutions are carried out simultaneously, such as the withdrawal and reform of foreign-funded financial institutions, the liquidation and rectification of futures institutions, etc., which has laid the foundation for the recovery of Hainan's banking and securities industries. At the same time, the establishment of policy bank branches, the establishment of four asset management company offices, etc., also provided new impetus for the recovery of Hainan's financial industry.

2.4 2004-2009: the financial sector recovered steadily and the performance of financial stability improved

With the continuous promotion of the disposal of overstocked real estate in Hainan, the results have gradually emerged, and Hainan's economy has shown a trend of accelerated growth. At the same time, the shareholding reform of state-owned commercial banks in the branches below the provincial level is in full force. All these promoted Hainan's financial industry to the track of stable recovery and healthy development. After years of losses, Hainan's banking industry turned the corner and made book profit in November 2004. In 2006, Hainan removed its "financial high-risk area" label. Since 2007, the focus of Hainan's financial work has shifted from the disposal of legacy financial problems to the planning of financial reform and development, and is committed to comprehensively improving the quality and level of financial services and enhancing the comprehensive strength and competitiveness of the financial industry.

In terms of financial supervision, the establishment of the Financial Work Office of the provincial people's Government has established a new coordination mechanism for financial development and supervision in Hainan Province. Hainan Provincial Banking Regulatory Bureau has strengthened the disposal of non-performing assets, the non-performing assets of commercial banks have been effectively controlled, and the credit granting of the head office of commercial banks to the jurisdiction of Hainan has been strengthened. At the same time, the Haikou Branch of the People's Bank of China actively promoted the construction of the province's credit information system, and took the lead in establishing the joint conference system for the construction of the social credit system in the country, which effectively promoted the formation of the credit economy in Hainan Province. Hainan Securities Regulatory Bureau formulated and implemented *the Implementation Plan for Comprehensive Management of Securities Companies* under the jurisdiction of Hainan, figured out the risk base of securities companies, comprehensively completed the rectification of risk problems of securities companies, realized the independent deposit management of customers, standardized the operation behavior of securities companies, and ensured the steady and upward development of Hainan's securities industry.

2.5 2010-2017: New opportunities for financial development and continuous improvement of local financial supervision

.In 2010, The State Council issued *Several Measures on the Construction and Development of Hainan International Tourism Island*, which will build Hainan into a international tourism island ,and make it an open island, a green island, a civilized island and an island of harmony by 2020. With the construction of Hainan International Tourism Island, the development of Hainan's financial industry has entered rapid development. The organizational system has become increasingly sound, the business scale has been further expanded, the quality of asset operation has been steadily improved, the service level has been continuously improved, and the support for economic and social development has been significantly enhanced.

In financial supervision,Hainan Provincial Financial Work Office, Haikou Central Branch of the People's Bank of China, Hainan Banking Regulatory Bureau, Hainan Securities Regulatory Bureau and Hainan Insurance Regulatory Bureau jointly form the main force of local financial supervision in Hainan, jointly maintain the sustainability and robustness of the development of Hainan's financial industry, and prevent the occurrence of systemic risks.

2.6 From 2018 to now: The road to explore the characteristics of financial development of Hainan Free Trade Port

Since April 13, 2018, the Party Central Committee decided to support the construction of Hainan Free Trade Pilot Zone, especially after the official release of the Overall Plan for the construction of Hainan Free Trade Port on June 1, 2020, the implementation scope of Hainan Free Trade Port has been officially established as the whole island of Hainan. Hainan's social and economic development has officially entered the fast lane, and Hainan's financial industry has shown a new trend of development. The number and scale of financial organizations in Hainan have expanded rapidly, and the number and quality of financial practitioners have been greatly improved. At the same time, bold innovations have been made in financial fields such as multi-functional free trade accounts, qualified overseas limited partners, and qualified domestic limited partners' overseas investment. However, the quality of listed companies is not high, the uneven distribution of social funds, regional risks and other problems still exist.

At the same time of financial opening and innovation, Hainan's financial supervision also presents a new trend in the aspects of institutional setup along with the reform of national institutions. On September 13, 2018, closely focusing on the strategic positioning of Hainan's "three districts and one center", Hainan Province established the Local Financial Supervision Administration, which became an agency directly under the Hainan Provincial People's Government. On May 13, 2024, Hainan Province established the Financial Commission of the Provincial Party Committee and the Financial Work Committee of the Provincial Party Committee to further improve the financial work system and mechanism under the leadership of the Party, and closely coordinate the financial development of Hainan Province, and closely coordinate the financial management of the central and provincial governments. At this point, the Financial Commission of the Provincial Party Committee and the Financial Work Committee of the Provincial Party Committee, the local financial Administration of Hainan Province, the Hainan branch of the People's Bank of China, the Hainan Securities Regulatory Bureau, and the Hainan Branch of the State Administration of Foreign Exchange jointly constitute the Hainan financial supervision system.

3. The practical problems of Hainan's financial supervision since the construction of the free trade port

3.1 The organizational structure of local financial supervision is not sound

At the provincial level, the Financial Commission of the Provincial Party Committee and the Financial Work Committee of the Provincial Party Committee, the Local Financial Administration of Hainan Province, the Hainan Branch of the People's Bank of China, the Hainan Regulatory Bureau of the China Securities Regulatory Commission (Hainan Securities Regulatory Bureau), and the Hainan Branch of the State Administration of Foreign Exchange jointly form the provincial financial regulatory core. At the city and county, among the four prefecture-level cities, Sanya set up the Financial Development Bureau, Haikou set up the financial Management Bureau, and Danzhou and Sanya set up branches of the financial supervision Administration. In other counties and cities, the financial supervision agencies are mainly completed by the county financial Office, the supervision team of the Banking and Insurance Regulatory Bureau, and the county branch of the People's Bank of China.

The organizational structure of financial supervision in Hainan Province presents an inverted pyramid distribution pattern at the provincial, municipal and county levels. Due to the lack of human and financial resources, weak professional skills and other factors, some prefecture-level and county governments have insufficient institutional setup and insufficient number of full-time personnel with law enforcement experience and level, which directly affects the efficiency and quality of local financial supervision. Weak ability to deal with financial risks.[1]

3.2 The division of powers and responsibilities in local financial supervision is not clear enough

On the background of Hainan Free Trade Port construction, Hainan's financial industry has made great progress, and there have been many attempts in financial opening and innovation. Social financing in Hainan is still an indirect financing mode represented by commercial banks, and non-mainstream financial organizations dominated by local and professional companies represented by small loan companies, financing guarantee companies, regional equity markets, financial leasing

companies are generally small in scale and have limited support for local economic development.

In the current local financial supervision system, local governments have limited supervision power and have to bear unlimited territorial financial risk disposal responsibilities. As a result, local governments are prone to form the problem of "emphasizing development and neglecting supervision, developing first and supervising later", which affects the performance of financial supervision functions. [2]In recent years, while the risks of illegal fund-raising and financial fraud in Hainan are emerging in an endless stream, the systemic risk problem is prominent and the financial anti-risk ability is weak. For example, listed companies such as HNA Group and Dadonghai A, which have continued to thunder in recent years, the local financial regulatory authorities often seem powerless when dealing with financial risks, and the agencies dispatched by the central financial regulatory authorities lack the initiative to supervise, which ultimately increases the difficulty of financial regulatory law enforcement. At the same time, with the acceleration of the construction of Hainan free trade Port, local financial institutions represented by small loan companies and private equity funds continue to grow, and their number and capital scale show a rapid growth trend, which puts forward higher requirements for the local financial supervision system in Hainan.

3.3 The reform of financial regulatory system lacks of the characteristics

The reform of financial supervision system of our country has always taken the strategy of top-down, gradually releasing power. On the one hand, from absolute centralization, local governments are gradually given limited decentralization, and local governments are not entitled to supervise and control. From absolute centralization, local governments have gradually been given limited decentralization, and local governments have changed from not having the right to supervise to having the right to supervise. While obtaining part of the power to supervise, local governments bear the corresponding risk disposal responsibility.

Hainan, as China's great attempt to explore the world free trade port, has achieved remarkable results in institutional integration and innovation, with more than 100 institutional innovations completed, involving medical care, finance, trade and other fields. In the financial field, bold attempts have also been made in the fields of multi-functional free trade accounts, qualified foreign limited partners, qualified domestic limited partners overseas investment. However, the supporting financial regulatory institutions are no different from those in other provinces and cities. In the future, the exploration of better financial innovation and opening requires a more relaxed and rigorous financial supervision soil.

3.4 The legal protection of financial supervision in Hainan Free Trade Port is not sound

The release of *The Opinions on Financial Support for Comprehensively Deepening Reform and Opening Up in Hainan* and *The Implementation Plan on Implementing the Opinions on Financial Support for Comprehensively Deepening Reform and Opening Up in Hainan* laid a solid foundation for the financial development and innovation of Hainan Free Trade Port, making up for Hainan's financial shortcomings and consolidating Hainan's financial foundation. However, up to now, Hainan Province has not issued local regulations on local financial supervision, while nearly 20 provinces, including Shandong, Jiangxi, Zhejiang, Sichuan and other provinces, have issued local financial Supervision Regulations, which serve as the main legal basis for local financial supervision.[3] The Hainan Free Trade Port Local Financial Supervision and Administration Regulations have not been officially released. The lack of legal provisions to match the financial opening and innovation has further weakened the actual effect of Hainan's financial supervision.

4. Hainan Free Trade Port financial supervision optimization path

4.1 Improve the management system of local financial regulatory departments at the city and county levels

At the provincial level, the financial leadership core is established with the Financial Committee of the Provincial Party Committee and the Financial Working Committee of the Provincial Party Committee as the leadership core, and the Hainan Provincial Financial Administration Bureau, the Hainan Branch of the People's Bank of China, the Hainan Regulatory Bureau of the China Securities Regulatory Commission, and the Hainan Branch of the State Administration of Foreign Exchange have a clear

division of labor to jointly form the financial leadership core, and comprehensively coordinate the financial development work of Hainan Province. At the provincial level, the financial leadership core is established with the Financial Committee of the Provincial Party Committee and the Financial Working Committee of the Provincial Party Committee as the leadership core, and the Hainan Provincial Financial Administration Bureau, the Hainan Branch of the People's Bank of China, the Hainan Regulatory Bureau of the China Securities Regulatory Commission, and the Hainan Branch of the State Administration of Foreign Exchange have a clear division of labor to jointly form the financial leadership core, and comprehensively coordinate the financial development work of Hainan Province.

Where conditions permit, all cities and counties shall set up local financial supervision and administration branches in a unified manner, which shall assume the supervision and risk prevention responsibilities of local financial organizations and financial activities within their jurisdiction, and shall no longer be attached to the government office, the finance bureau and other departments, so that they can have full-time supervision responsibilities. At the same time, it is independent of the city and county governments and directly responsible for the local financial supervision Bureau of Hainan Province to achieve vertical leadership.

4.2 Strengthen the rule of law construction of financial supervision in Hainan Free Trade Port

The allocation of local financial regulatory power is more realized through the form of institutional reform, laws and regulations, and institutional reform is mostly top-down from the central government, the formulation of laws and regulations must be led by the central government, and the coordination and brewing process is long.[4] The Hainan Free Trade Port Law passed on June 10, 2021 provides a lot of legislative facilitation support for the management regulations and system innovation of various industries in Hainan Free Trade Port.

Hainan Free Trade Port should be bench-marked to international free trade ports such as Singapore, etc, and establish a free trade port rule of law system based on the *Hainan Free Trade Port Law*. Accelerate the formulation of the *Hainan Free Trade Port Local Financial Supervision and Administration Regulations*, determine the power boundaries and responsibility requirements of local financial supervision departments, and provide a strong legal guarantee for financial supervision.

4.3 Explore and try innovative financial supervision methods suitable for the development of Hainan Free Trade Port

With the two-tier supervision mode dominated by the central government and supplemented by local supervision, Hainan's financial institutions have developed rapidly, regional financial markets have been widely established, and the privatization trend of financial institutions has been increasingly strengthened. In this process, the blind expansion of urban commercial banks, frequent disputes over illegal private lending, local government financing liabilities are constantly exposed, and local financial risks are highlighted.

As an organic integration product of financial supervision and technology, regulatory technology comes into being and provides strong technical support for improving the regulatory level and efficiency of financial regulators and reducing the compliance cost of financial institutions. For example, in the construction of Hainan Free Trade Port, we can try to apply the regulatory sandbox. On the basis of protecting the rights and interests of financial consumers, we can strengthen cooperation among various departments to solve the problems of scattered local financial regulatory bodies, unclear regulatory boundaries and lack of coordination in supervision. We will create a new situation in local financial supervision and improve the efficiency and level of local financial supervision.[5]

5. Conclusion

As Chinese largest special economic zone, largest pilot free trade zone and the only free trade port with Chinese characteristics, Hainan has unlimited potential for social and economic development. As the lifeblood of economic development, the opening and innovation of the financial industry and risk supervision complement each other. Therefore, it is necessary to establish a financial supervision system in line with the modern financial characteristics of Hainan Free Trade Port, coordinate financial innovation and development, establish and improve the legal system of financial supervision of the free trade port, promote full coverage of financial supervision, achieve financial innovation and development, and become a new highland of China's economic opening.

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