

Failure Case Study of Operational Risk Management of Wealth Management Institution — Taking the 2025 Zhejiang Financial Assets Exchange (ZFAE) Default as an Example

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Abstract

In recent years, the deepening development of China's financial market and the continuous accumulation of household wealth have jointly driven the rapid expansion of the wealth management industry. However, some institutions have suffered from frequent operational risk incidents due to corporate governance deficiencies, lack of internal controls, and regulatory arbitrage behaviors, seriously threatening the legitimate rights and interests of investors and the stability of the financial system. The "Zhejiang Financial Assets Exchange (ZFAE) Product Default Incident" exposed in 2025 is a typical example. This incident involved the delayed redemption of 23 wealth management products, with the unpaid principal amount reaching approximately 11.7 to 20 billion yuan, affecting over 12,000 investors and triggering widespread public concern. Taking this case as the research object, this paper systematically analyzes the event evolution, organizational structure characteristics, product design logic, and risk transmission pathways, revealing multiple institutional loopholes in operational risk management, including: failure of governance structures, ineffective compliance mechanisms, severe distortion of information disclosure, lack of risk isolation mechanisms, and systemic regulatory arbitrage behaviors. This study deeply diagnoses the root mechanisms of risk formation and proposes targeted improvement suggestions, aiming to enhance the operational risk management efficiency of financial institutions and provide theoretical references and practical basis for the improvement of regulatory policy systems.

Keywords

wealth management; operational risk; risk management; Zhejiang Financial Center; default events; investor protection; regulatory arbitrage

1. Introduction

1.1. Research Background

Entering the third decade of the 21st century, China's wealth management market has entered a stage of structural transformation. According to the "2024 China Wealth Management Market Report" [2] released by the Asset Management Association of China, by the end of 2023, the scale of China's broad wealth management market had exceeded 130 trillion yuan, with bank wealth management, trusts, public funds, private funds, and various local financial asset trading platforms forming a multi-level service system. Against the backdrop of the gradual breakdown of the "housing is for living, not for speculation" policy and rigid redemptions, investors' demand for professional and diversified asset allocation services has grown increasingly strong, driving the rapid expansion of wealth management institutions.

However, amid the industry's rapid expansion, some institutions have neglected the foundational development of operational risk management while pursuing scale expansion and short-term gains. Operational risk—defined as the risk of losses caused by inadequate internal processes, human errors, system flaws, or external events—has become a critical component of wealth management institutions' risk exposure. The Bank for International Settlements (BIS) noted in its 2023 Global Financial Stability Report [1] that emerging market wealth management institutions experience nearly twice the incidence of operational risk events compared to mature markets, with most incidents concentrated in areas such as governance failures, conflicts of interest, and regulatory evasion.

The "Zhejiang Financial Assets Exchange (ZFAE)" collapse in October 2025 epitomized this accumulated risk. Originally a provincial government-backed financial asset trading platform, it saw 23 wealth management products abruptly suspend redemptions, involving massive funds and a broad investor base—mostly middle-aged and elderly citizens. The incident not only exposed systemic flaws in the institution's operational management but also revealed deeper issues in local financial platforms during their transformation: regulatory blind spots, ambiguous accountability, and inadequate investor protection mechanisms.

1.2. Research Significance

1.2.1. Theoretical Significance

This study applies the theory of operational risk management to a specific case, expands the applicable boundary of COSO-ERM framework in local financial asset trading platform, enriches the empirical research of the four-dimensional model of operational risk "governance-process-system-personnel", and provides new case support for the risk governance research of financial intermediaries.

1.2.2. Practical Significance

Through an in-depth analysis of the Zhejiang Financial Assets Exchange (ZFAE) incident, this study reveals how wealth management institutions progressively erode their risk control capabilities amid a culture of

"pseudo-guaranteed returns," regulatory arbitrage, and information asymmetry. The findings provide risk warning signals and corrective pathways for similar institutions, while also offering decision-making references for regulators to identify risk spillover mechanisms of "quasi-financial institutions" and enhance their penetrating supervision.

1.3. Research Methods and Structure

This study employs case study methodology, integrating publicly available data, policy documents, and online rights protection information to construct event timelines and risk transmission maps. It applies the operational risk classification method (based on Basel III) to categorize risk points, while diagnosing systemic deficiencies through governance structure analysis and compliance reviews.

The paper is structured as follows: Part I presents the introduction; Part II details the institutional evolution and historical events of Zhejiang Financial Center; Part III analyzes the theoretical framework and evaluation criteria for operational risk management; Part IV systematically examines the specific manifestations of operational risk management failures; Part V diagnoses the root causes of risks; Part VI proposes countermeasures; and Part VII summarizes the research conclusions with policy implications.

2. Institutional Evolution of Zhejiang Financial Assets Exchange (ZFAE) and the Process of the "Blow up" Incident

2.1. Establishment of the Institution and Initial Positioning

Established in 2013, Zhejiang Financial Asset Exchange Center is a regional financial asset exchange jointly founded by Zhejiang Financial Holding Group, Ningbo Urban Construction Investment, China Minsheng Bank (CMBC), and Guosen Securities, with a registered capital of 100 million yuan. Approved by the Zhejiang Provincial Government, the center was established to implement the national policy of revitalizing local financial assets and facilitating non-standard asset circulation. Its core operations include non-performing asset securitization, accounts receivable transfers, and issuance of private placement instruments.

Despite holding provincial-level approvals, it has never publicly disclosed whether it has obtained formal financial business licenses from the State Administration of Financial Supervision (formerly the China Banking and Insurance Regulatory Commission) or the People's Bank of China. Its legal status lies between 'administrative institutions' and 'market-oriented platforms,' resulting in a ambiguous identity as a 'quasi-financial institution.' [6]

2.2. Business Model and Product Design

In its early operational phase, Zhejiang Financial Assets Exchange (ZFAE) positioned 'government credit endorsement' as its marketing cornerstone, rolling out multiple government bond-style wealth management products to the public. These products

were nominally invested in local infrastructure projects, PPP projects, or government receivables, with an expected annualized yield ranging from 5.5% to 7.5%—significantly higher than contemporaneous bank deposits and government bond returns. The marketing materials prominently emphasized their 'provincial platform status, safety, and stability.'

The products are sold to individual investors through an online APP and offline service outlets, with a minimum investment of 10,000 yuan per transaction. The primary customer groups include retired middle-aged and elderly individuals, small business owners, and residents of third-and fourth-tier cities. The platform claims that all products undergo "internal risk control review" and "third-party rating," and issue an "AAA-level safety rating report."

However, as evidenced by the contract documents provided by investors post-issuance, the product was legally structured as a 'non-public private placement instrument' —not qualifying as publicly issued securities under China's Securities Law, nor registered with any central clearing system—raising clear suspicions of regulatory arbitrage.

2.3. Equity Change and Platform Transformation

In October 2024, the Zhejiang Provincial Financial Regulatory Bureau announced the revocation of Zhejin Center's financial asset trading license, terminating its status as a regional financial trading platform. Concurrently, the center initiated business registration procedures and was officially renamed Zhejin Asset Operation Co., Ltd. in January 2025. The company's ownership structure transitioned from state-controlled to privately held, with its former largest shareholder, Zhejiang Financial Market Investment Co., Ltd., completing the equity divestment process.

This change was not adequately communicated to existing investors, nor were transitional arrangements or risk warnings established. A significant number of investors unknowingly found that the issuers of their "government bond" -type products had shifted from state-owned platforms to private enterprises, resulting in a fundamental erosion of their credit foundation.

2.4. The Outbreak and Subsequent Development of Thunderstorm Events

In October 2025, Zhejiang Financial Assets Exchange (ZFAE) announced that 23 of its wealth management products would face delayed redemptions due to "market environment changes and liquidity constraints," affecting over 12,000 investors with principal amounts ranging from 11.7 billion to 20 billion yuan (depending on calculation methods). The announcement neither provided a clear repayment timeline nor disclosed the funds' destination or asset composition. [7]

The incident quickly triggered a wave of collective rights protection. Investors found that:

- Most of the "government projects" in the product promotion cannot be

verified;

- The third-party rating agency is affiliated with the platform, and the rating process lacks independence.
- The actual fund flow mainly goes to real estate enterprises, highly indebted local platform companies and shareholder-affiliated enterprises.
- Before the payment crisis, there were large-scale asset transfers and cashing out by executives.

Some investors attempted to seek compensation through civil litigation, but the difficulty was compounded by the inclusion of 'disclaimer clauses' in the product contracts, such as 'market risks are borne by the investor' and 'policy adjustments do not constitute a breach' which made legal recourse extremely challenging.

2.5. Social Impact and Public Opinion Evolution

The incident rapidly escalated on social media platforms, with the hashtag 'Zhejiang Financial Assets Exchange (ZFAE) Collapse' garnering over 500 million views. Across multiple regions, investors staged mass petitions and blockaded local government offices. Online discourse widely questioned:

- Should Provincial Finance Department Bear Joint and Several Liability for Initial Shareholder Identity?
- Does the local financial regulatory authority fulfill the obligations of risk assessment and investor protection before revoking the qualification?
- Does the Change of the Name of the Platform and the Change of the Equity constitute the "Golden Cicada Shedding its Shell" to evade the Debt?

Despite the central authorities' acknowledgment of the issue, no cross-departmental joint investigation team has been formed, resulting in sluggish progress in rights protection. Investors remain in a disorganized and strategy-confused state.

3. Theoretical Framework and Evaluation Criteria of Operational Risk Management

3.1. Definition and Scope of Operational Risk Management

The Basel Committee on Banking Supervision's Operational Risk Management Approach (2023 Revision) [1] defines operational risk as "the risk of loss arising from inadequate or failed internal processes, personnel, systems, or external events." It covers legal risks but excludes strategic and reputational risks, although the latter are often byproducts of operational risks.

In wealth management institutions, operational risk is primarily manifested in the following aspects:

3.1.1. Risk governance and control: including conflicts of interest among shareholders, board dysfunction, and marginalization of risk management departments;

3.1.2. Compliance risks: non-compliance with regulatory requirements, misleading

advertising, and circumvention of investor suitability management;

3.1.3. Process risks: product design flaws, unfair contract terms, and opaque redemption mechanisms;

3.1.4. System and Data Risks: IT system vulnerabilities, customer data breaches, and incomplete transaction records;

3.1.5. Personnel Risks: ethical misconduct by executives, non-compliant sales practices by employees, and internal fraud.

3.1.6. External event risks: sudden regulatory policy changes, collusion among third-party institutions, etc.

3.2. Application of COSO-ERM Framework in Wealth Management Institutions

The COSO (Committee of Sponsoring Organizations of the Treadway Commission) [5] Enterprise Risk Management Framework is an internationally recognized standard for risk governance, comprising five key components:

3.2.1. Governance and Culture: Whether the board of directors and senior management have established mechanisms for risk awareness and accountability;

3.2.2. Strategy and Goal Setting: Whether the risk appetite aligns with the institutional strategy;

3.2.3. Performance (Risk Identification and Assessment): Whether a dynamic risk assessment mechanism has been established;

3.2.4. Review and Correction (Monitoring and Reporting): Whether risk information is properly disclosed to higher levels;

3.2.5. Information, Communication and Reporting: Ensure that internal and external information is transparent, accurate, and timely.

In wealth management institutions, the COSO framework should be prioritized for product lifecycle management, covering all stages from design and sales to existence, information disclosure, and liquidation.

3.3. Criteria for Determining Failure of Operational Risk Management

This paper constructs a five-dimensional evaluation standard for the failure of operational risk management in wealth management institutions by combining regulatory practice and academic research.

Table 1. Five-dimensional evaluation standard for the failure of operational risk management in wealth management institutions

Dimension	Evaluating indicator
Governance effectiveness	The Independence of Shareholders' Structure, the Performance of the Board of Directors and the Risk Committee, and the Linkage of the Executive Incentive with the Risk
Compliance integrity	Whether the product has obtained legal qualifications, whether it has been registered, and whether its sales comply with the principle of appropriateness
Process transparency	Whether the investment direction is traceable, the frequency and quality of information disclosure, and whether the contract terms are fair
System reliability	Whether the system has an independent accounting system, whether customer assets are isolated, and whether data is auditable
Investor protection mechanism	Whether to set up a risk reserve, whether to have independent custody, and whether to provide complaint and relief channels

If an institution has serious deficiencies in more than three dimensions, it is deemed to have failed in operational risk management.

4. Specific Manifestations of Operational Risk Management Failure at Zhejiang Financial Center

4.1. Governance Structure Alienation: From "Government Platform" to "Private Enterprise Thunder" Responsibility Transfer

4.1.1. Failure to fulfill the obligation of notification in case of shareholder change

In January 2025, Zhejiang Financial Assets Exchange (ZFAE) completed the exit of state-owned shares and the change of private enterprise control, but neither issued an announcement to existing investors nor re-signed the risk disclosure statement. This action violates Article 51 of the Trust Law, which stipulates that 'beneficiaries must be notified of trustee changes,' constituting a significant procedural flaw.

4.1.2. Unclear Risk Liability Subjects

The platform's former largest shareholder was a subsidiary of the Provincial Department of Finance, which granted it quasi-governmental credit status. By divesting its stake before risks materialized, the company effectively shifted the financial burden to a private entity with limited capacity. This 'shell-swap' maneuver made it impossible for investors to trace the original responsible party, severely violating the principle of substance over form.

4.1.3. The Board of Directors and the Risk Committee are virtually non-functional

Public records indicate that Zhejiang Financial Assets Exchange (ZFAE) did not convene formal board meetings during 2023-2024. Its risk management was concurrently handled by the operations department, lacking independent budgetary and personnel authority. When underlying assets defaulted on multiple products, the center neither initiated stress tests nor issued risk warnings.

4.2. Compliance Mechanism Virtualization: Regulatory Arbitrage and Qualification Failure

4.2.1. Legality of Business Qualifications in Question

Despite holding approval documents from the Zhejiang Provincial Government, Zhejiang Financial Assets Exchange (ZFAE) failed to obtain the Financial Business License issued by the national financial regulatory authority, thus lacking the legal qualification to issue public or quasi-public financial products. Its so-called 'wealth management plans' were essentially illegal fundraising activities, suspected of violating Article 2 of the Regulations on the Prevention and Disposal of Illegal Fundraising [3].

4.2.2. Unregistered products circumvent regulatory scrutiny

All 23 involved products were not registered with the Central Government Bond Depository and Clearing Corporation or the China Securities Depository and Clearing Corporation, nor were they connected to the "National Financial Assets Trading Information Monitoring System", creating a regulatory blind spot.

4.2.3. Lack of investor suitability management

The platform failed to conduct risk assessments for investors, resulting in a large number of elderly individuals over 70 and retired employees purchasing high-risk non-standardized products, which violates Article 14 of the Securities and Futures Investor Suitability Management Measures [4] regarding 'risk matching'.

4.3. Information Disclosure Distortion and Fraudulent Propaganda

4.3.1. False Ratings and Credit Backing

The platform claimed its product had received an "AAA-level safety rating," but investigations revealed that the rating agency was a shell company registered in a free trade zone, lacking proper rating qualifications and having equity ties with the platform. This constitutes "false advertising" as prohibited under Article 8 of the Anti-Unfair Competition Law.

4.3.2. Lack of transparency in fund allocation

The investor contract merely stated 'for a specific infrastructure project' without specifying the project number, fund allocation plan, or regulatory account details. Subsequent investigations revealed that part of the funds were channeled to shareholders' affiliated real estate companies to repay high-interest debts, constituting misappropriation of client funds.

4.3.3. Inadequate Risk Disclosure

The risk disclosure section in the contract employs small font and excessive technical jargon, rendering it incomprehensible to average investors. Crucial clauses such as 'postponed redemption does not constitute default' and 'market risks are borne by the investor' lack prominent labeling, violating Article 26 of the Consumer Rights Protection Law.

4.4. Risk Isolation and Lack of Internal Control Mechanisms

4.4.1. Assets not under independent custody

The product in question failed to engage an independent third-party custodian, with funds flowing directly into Zhejiang Financial Center's proprietary account to form a capital pool—a practice that violates Article 11 of the 'Guidelines on Regulating Asset Management Business of Financial Institutions' (the Asset Management New Rules), which explicitly prohibits capital pools and independent custody.

4.4.2. Risk-Free Reserve System

The platform has not set aside any risk reserves, purchased credit insurance, or

established a repayment fund, leaving it without a buffer mechanism when risks occur.

4.4.3. Absence of Internal Audit

From 2022 to 2024, Zhejiang Financial Assets Exchange (ZFAE) did not engage external auditors to conduct specialized audits on its wealth management products. The financial reports were issued by affiliated accounting firms, raising concerns about their independence.

4.5. System and Data Management Defects

4.5.1. The IT system cannot support penetration queries

Investors cannot track underlying asset movements, fund flows, or transaction records through the app. The system only provides simulated 'expected returns,' effectively shielding information.

4.5.2. Weak Data Backup and Security Mechanisms

After the market crash, the platform's servers were temporarily shut down, causing investors' transaction records to be lost and making it harder to provide evidence for rights protection.

4.6. The absence of investor protection mechanisms

4.6.1. No mechanism for supporting class actions

The platform neither provides a consultation channel for investor representatives nor has a dedicated complaint handling officer.

4.6.2. Blockage of Rights Protection Channels

Investors attempt to protect their rights through civil litigation, but the case filing rate remains below 10% due to reasons such as changes in the defendant's identity, unfavorable contract terms, and insufficient evidence.

5. Cause Diagnosis of Operational Risk Management Failure

5.1. Internal Causes

5.1.1 Lack of risk culture: Management prioritizes short-term scale expansion, treating "payment rate" as the sole performance metric while overlooking long-term risk accumulation.

5.1.2 Distorted Incentive Mechanism: The sales team's commission system based on sales volume incentivizes the rapid development of short-term, low-margin products, resulting in an oversupply of high-risk products.

5.1.3 Insufficient expertise: Most risk control teams lack financial professional training, making them unable to identify complex structured risks.

5.2. External Causes

5.2.1 Regulatory arbitrage opportunities exist: Local financial platforms exploit

provincial-level approvals to circumvent central oversight, creating regulatory blind spots.

5.2.2 Regulatory coordination gaps: The Provincial Financial Regulatory Bureau failed to notify public security, market supervision, and judicial authorities simultaneously after revoking the qualification, resulting in delayed risk resolution.

5.2.3 Inadequate judicial remedy mechanisms: The lack of widespread adoption of class action litigation, coupled with high costs and low efficiency for individual rights protection.

5.3. Institutional Vulnerabilities

5.3.1 The ambiguous legal status of "quasi-financial institutions": neither banks nor trusts, they are not fully regulated by the Banking Supervision and Administration Law or the Trust Law.

5.3.2 Absence of investor protection mechanisms: There is no financial consumer relief mechanism akin to the Securities Investor Protection Fund.

6. Response Strategies and Policy Recommendations

6.1. Recommendations for Wealth Management Institutions

6.1.1 Restructuring Corporate Governance: Ensure the independence of the board of directors and the risk committee, and appoint external independent directors and professional risk officers.

6.1.2 Establish a comprehensive risk control system covering the entire lifecycle, including product design, sales, post-investment management, and information disclosure.

6.1.3 Implementing Penetrative Information Disclosure: Provide investors with a detailed list of underlying assets, flow charts of capital movements, and risk change alerts.

6.1.4 Risk Reserve and Independent Custody Mechanism: A 1% to 3% compensation reserve shall be set aside based on the product's scale.

6.2. Recommendations to Regulatory Authorities

6.2.1 Clarify the regulatory body for 'quasi-financial institutions': The State Administration of Financial Supervision shall lead the establishment of a 'functional supervision' list.

6.2.2 Strengthen dynamic qualification management: Prior to revoking business qualifications, existing operations must be liquidated or risk-isolated.

6.2.3 Implement a retrospective investor suitability mechanism: Enforce sales audio-video recording and cooling-off period requirements for elderly or less-educated investors.

6.2.4 Promote pilot collective litigation: Introduce the "representative action" mechanism in financial disputes to reduce the cost of rights protection.

6.3. Advice to Investors

6.3.1 Enhance financial literacy: Don't blindly trust 'government endorsement'—always verify the qualifications of institutions and products.

6.3.2 Maintain a complete evidence chain: including contracts, transfer records, promotional materials, and communication records.

6.3.3 Rational Rights Protection: Asserting rights through legal channels rather than mass protests.

6.4. Recommendations for Social Governance

6.4.1 Support the development of professional rights protection organizations: Encourage lawyers, accountants, and IT experts to form public interest teams to assist investors.

6.4.2 Establish a Financial Dispute Mediation Center: Provide a low-cost, high-efficiency alternative dispute resolution mechanism.

7. Conclusion and Implications

The Zhejiang Financial Center's wealth management collapse stands as a classic systemic risk case triggered by total failure in operational risk management. At its core, it transcends mere market volatility or isolated defaults—it represents a 'systemic trap' forged by governance distortions, regulatory loopholes, information fraud, and inadequate investor safeguards. This incident serves as a stark warning:

7.1 Wealth management institutions must prioritize operational risk management at a strategic level, and must not sacrifice the risk bottom line for the sake of scale.

7.2 Regulatory oversight must go beyond 'formal compliance' to focus on substantive risks and investors' actual losses.

7.3 Investor protection should shift from "post-event remedies" to "preemptive safeguards", establishing a comprehensive protection mechanism across the entire chain.

7.4 Financial stability must not rely on the illusion of rigid redemptions, but must be grounded in transparency, compliance, and the rule of law.

In the future, as the wealth management market advances toward greater inclusiveness and digitalization, the capability to manage operational risks will serve as the "ballast stone" of institutional core competitiveness. Only by adhering to the trust spirit of "being entrusted with a mission and fulfilling it faithfully" can the industry achieve sustainable development.

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