

Behavioral Ethics for Financial Institutions: Falling Over the Moral Cliff

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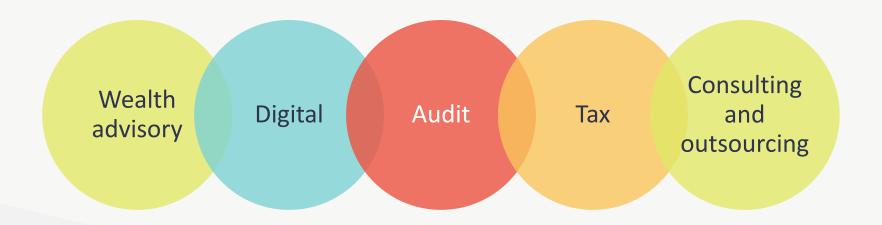
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Session CPE Requirements

- You need to attend 100 minutes to receive the full 2 CPE credits.
 - There will be 8 polling questions throughout the presentation. You must respond to a minimum of 6 to receive the full 2 CPE credits.

Both requirements must be met to receive CPE credit







Learning Objectives

- 1. Recognize the patterns and behaviors that can often lead to ethical scandals in business
- 2. Oldentify counterbalancing forces that encourage ethical behavior and drive ethical culture
- Recognize ethical considerations of bias, fairness, and trust related to the use of AI
- Describe how behavioral ethics considerations apply to real-world examples in the financial services industry







Ethics in the News



Guess Who?

"Another crooked bank official gets sentenced," reads the latest headline related to this bank accounting scandal. This bank in Chicago was shut down after regulators found it insolvent with \$66 million in nonperforming loans. The underlying trigger was a massive embezzlement disguised as real estate loans; many issued without documentation or any expectation of repayment. Total embezzled through fake loans was at least \$31 million, with over \$82 million still missing. The kicker – a former CFO warned regulators, but no action was taken until six years later.





Guess Who?

In 2019, a viral tweet revealed a tech-branded credit card giving men higher limits than women with similar finances. The backlash sparked a New York investigation, exposing how "gender-blind" AI can still reflect bias. Regulators pushed for transparency, forcing changes to the model and service practices.





Polling Question #1

Which of these ethical headlines were you most familiar with?

- Washington Federal Bank for Savings
- Apple Card
- Neither of the above they're both news to me!





Guess Who?

This Bank perpetrated tax fraud by helping their clients hide more than \$4 billion from the IRS. The Bank operated an elaborate system designed to help wealthy clients evade their taxes in concealed offshore accounts. Employees helped clients fill out false documentation to maintain the illusion of compliance while violating U.S. tax laws, with at least 475 undeclared accounts containing billions in assets. The Bank entered a guilty plea, admitting to the fraud and agreed to pay out \$510 million in penalties.





Guess Who?

This Bank was under investigation by regulators for incorrectly charging fees to low-income earners who receive medical and disability payments. The Bank announce 770,000 customers would be refunded a total of \$60 million dollars. That was after 150,000 customers were earlier paid back \$33 million in unfairly charged fees.





Polling Question #2

Which of these ethical headlines were you most familiar with?

- Credit Suisse
- Commonwealth Bank
- Neither they're both news to me!







Patterns of Corporate Scandals



Good Character Can Be Undermined by Dark Patterns



Dark Pattern #1

Rigid Ideology

- Leaders become so focused on a narrow goal—for example, profit maximization or market dominance—that they lose sight of the ethical implications of their decisions
- Also known as ethical fading





Bright Pattern #1 – Holistic Responsibility

Ethical decisions

Holistic
 responsibility
 involves making
 choices that
 prioritize user well being and ethical
 outcomes, not just
 immediate goals or
 financial goals

Considering longterm impact

 Organizations must evaluate the longterm effects of their products or decisions, ensuring actions benefit users and society over time

Building trust and sustainability

 Adopting holistic responsibility prevents harm, builds user trust, and encourages sustainable practices in digital development





Dark Pattern #2 – Toxic Leadership

Toxic leadership can involve either bad actors who seize the reign of power or normal leaders who can make poor moral choices.

There is a tendency to follow our leaders even when we know in our guts that they are asking us to do things that are wrong.





What kind of culture do you want to create?

How is Accountability
Enforced?

Do you Want to Know if There is a Problem?







Bright Pattern #2 – Speak Up Culture

Fostering encouragement and protection

 Speak up culture creates an environment where employees feel safe to express concerns, leading to greater workplace transparency and accountability. This MUST include protection from punishment.

Identifying and addressing harm

 Encouraging open dialogue helps organizations identify and address unethical practices early, preventing harm and building trust.

Empowering individuals

 Speak up culture empowers individuals to challenge unethical behaviors, supporting a healthier and more ethical work environment.





Polling Question #3

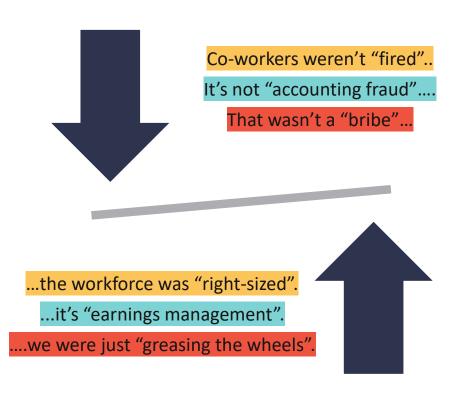
How do you encourage employees to speak up?

- Fraud hotline
- Training
- Reward program
- All or combination of the above
- Other





Dark Pattern #3 – Manipulative Language



Manipulative language can distort one's view or hide ethical issues before them





Bright Pattern #3 – Moral Conversations

Role of moral dialogue

 Open moral conversations help reveal manipulative language and clarify ethical concerns, making issues more transparent.

Challenging misleading terms

 By questioning misleading words, individuals can reframe discussions to spotlight core values and true ethical responsibilities.

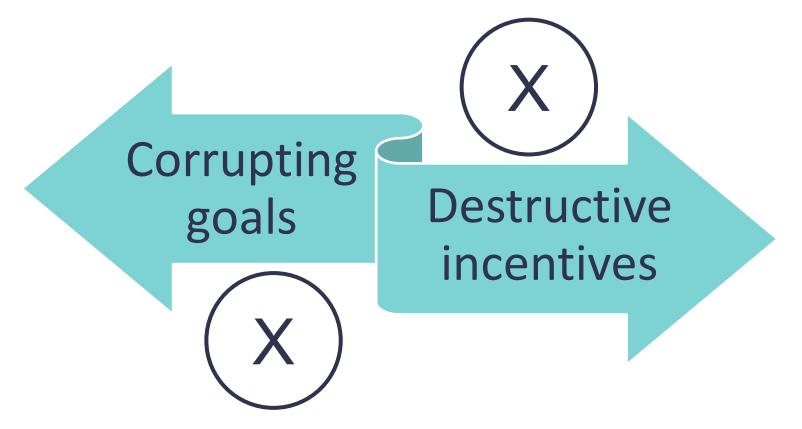
Fostering transparency

 Transparency and accountability grow when people recognize and challenge language that hides moral responsibilities.





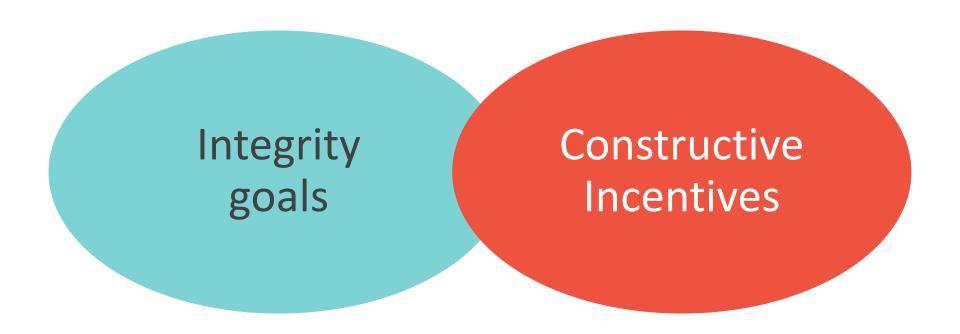
Dark Patterns #4 and #5







Bright Patterns #4 and #5 - Promote Ethical Action







Polling Question #4

Which of the following have you seen incentivized/prioritized so heavily by leadership that it resulted in unethical behavior?

- Loan Growth / Credit Performance
- Account Openings
- Customer Satisfaction / Customer Appeasement
- Return on Equity / Return on Assets
- All of the above





Dark Pattern #6 – Ambiguous Rules

Grey areas breed scandal

Employee expense reimbursement

- Vague rules and documentation requirements
- Limited training on review expectations

Executive bonus plans

- Incentivizing appropriate behavior
- Monitoring appropriately

Internal control performance

- Effectiveness and diligence of control
- Completeness and accuracy of reporting





Internal Controls and Ethics

Human nature is to look the other way if it is an easier path

Are employees incentivized to create a strong control environment?

Are control operators adequately trained?

Are fraud hotlines available for employees?





Internal Audit



Primary objective is the internal control structure of the organization



More detailed, covers all aspects of the organization including financial, operational and regulatory items



More control vs. process



Limited materiality considerations



How are we determining if we have a sound control structure?





Completeness and Accuracy

How was completeness and accuracy of reports used in a control validated by management?

Internal audit needs to use the exact same reports when testing controls





Polling Question #5

How are control operators held accountable for control deficiencies at your organization?

- Compensation reduction
- Required to present to governance on how deficiency will be fixed
- Document planned response
- Other





Bright Pattern #6 – Moral Clarity



Integrity in transactions



Legal compliance



Human rights



Sustainable production





Dark Pattern #7 – Perceived Unfairness

Perceived Unfairness

- People participate in illegal actions when they perceive they are restoring justice
- Ledger metaphor





Bright Pattern #7 – Organizational Fairness



Distributive fairness

Distributive fairness relates to how resources and rewards are shared among organization members, ensuring equity and justice.

Procedural fairness

Procedural fairness focuses on the transparency and consistency of organizational decision-making processes, building trust and legitimacy.

Interactional fairness

Interactional fairness emphasizes respectful and honest treatment in interpersonal exchanges within the organization, fostering a positive environment.





Dark Pattern #8 – Dangerous Groups







Conformity pressure



In group/out group





Bright Pattern #8 – Courageous Upstanders

Challenging unethical systems

Upstanders confront unfair practices, showing moral courage by questioning and resisting harmful norms

Risking for justice

Speaking out against injustice may come at a personal cost, but upstanders persist despite risks to safety or reputation

Power of collective action

When resilient individuals join together, their integrity drives powerful, meaningful transformation within society





Dark Pattern #9 – Slippery Slope

Incrementalism

- Small incremental changes in our behavior can lead us to unconsciously lower our ethical standards over time
- The slippery slope that often causes people to slide unintentionally into unethical behavior





Are we becoming complacent?



Bright Pattern #9 – Virtuous Circle



The concept that someone who does the right thing when times are tough can serve as a role model for others who, in turn, can serve as a role model for yet others...the next thing you know, you've got a virtuous circle





"Decide what you stand for. And then stand for it all the time."

Clayton Christensen



Polling Question #6

Which of these bright patterns do you think is the most important for companies to implement?

- Moral clarity
- Organizational fairness
- Moral conversations
- Speak up culture with allyship
- Holistic responsibility







Increasing Use of Al...but Don't Forget the Ethics!





Al Adoption and Market Momentum

78% of companies report at least some AI adoption

McKinsey 2024 State of Al Global Survey

Global AI spend projected to hit \$631B by 2028

 IDC's Worldwide AI and Generative AI Spending – Industry Outlook

Generative AI could add \$4.4 T in annual corporate profits

McKinsey



Trust and reliability



Fairness and impartiality

Security and data privacy

Morality and beneficence





Polling Question # 7

Which AI risk worries you most?

- Inaccurate, unreliable, lack of credibility
- Bias and lack of fairness
- Privacy and data misuse
- Maleficence, lack of morality





Trust and Reliability

Questions about accuracy

ChatGPT hallucinations

Coding / data limitations

Invalid predictions

Prioritizing a confident response over uncertainty















Al in Banking



Credit underwriting



Human resources



Marketing



Customer profitability





"It is imperative that we build intelligent systems that behave *morally*. For them to work and live with us, we need to trust such systems, and this requires that we are reasonably sure they behave according to values that are aligned to human values."

Andrea Loreggia





Questions?





Polling Question # 8

I would like someone from CLA to contact me to discuss the following:

- Al, automation, data, and digital solutions
- Enterprise risk internal audit, risk management, strategic planning, etc.
- Credit review services
- Outsourced accounting and advisory services
- Nothing at this time





Thank you!

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