



## Economic Review

# Bank Financial Restatements and Market Discipline

by: W. Blake Marsh and Raluca A. Roman

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Bank shareholders and depositors exert market discipline on banks that misreport financial statements.

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Banks may reissue financial statements for several reasons, ranging from simple accounting or clerical errors to fraud. Regardless of the reason, financial restatements send negative signals to the public, potentially driving stakeholders to undertake actions that are costly to the restating bank. These actions constitute “market discipline” and may incentivize banks to report financial information accurately. But whether financial restatements lead to market discipline is an empirical question. For example, strict bank regulation might blunt disciplinary effects if stakeholders believe regulations prevent excessive risk-taking.

W. Blake Marsh and Raluca Roman investigate whether three types of bank stakeholders—shareholders, depositors, and loan customers—discipline banks that misreport financial statements. They find strong empirical evidence that shareholders and depositors exercise market discipline on banks, and limited evidence that loan customers exert discipline. Overall, stakeholders’ reactions to bank restatements are economically important, suggesting restating banks face higher costs consistent with market discipline.

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