The Fed - The Rise of Nonbanks and the Quality of Financial Services Evidence from Consumer Complaints

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We show that as nonbanks' market share increases in a local residential mortgage market, the quality of mortgage services in the market improves. Two instrumental variable analyses exploiting (1) stress tests conducted by the Federal Reserve, and (2) mortgage industry surety bonds required by each state confirm this finding. We find evidence that as nonbanks grow their market share, they develop a specialty in servicing lower-income borrowers and increase investment in technology, leading to improved service quality. This improvement in service quality is more salient in counties with a higher percentage of minority populations.

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