THOMSON REUTERS INSTITUTE & FINANCIAL INSIGHTS

Law Firm Financial Index

Q4 2025 Executive Report | Issued 2.10.2026

Firms sail to strong finish as the winds shift

Law firms closed 2025 with sails full and coffers flushed as the year's final quarter delivered one of the strongest finishes in recent memory. Even as the champagne flows, however, the winds may already have begun to shift. The Thomson Reuters Institute's Law Firm Financial Index (LFFI) fell 2 points to a score of 61 as legal demand growth slowed. The two-point drop snapped a yearlong upward streak; and, while a modest dip taken on its own, it may signal a broader realignment that is perhaps already underway.

The Index's decline was driven almost entirely by decelerating demand growth, which slowed to a still-strong 3.3% in Q4, from 3.9% year-over-year growth in Q3. More telling than this headline figure was a quieter changing of the guard beneath the surface. Transactional[1] began cooling from their Q3 peaks, with weekday-adjusted[2] growth easing to 4.0% from 4.6%. At the heart of this shift was a remarkable slamming of the brakes in M&A work, in which demand growth fell 5 percentage points from its Q3 pace. Filling the void, bankruptcy work surged, particularly in December, as counter-cyclical[3] re-emerged as the primary engine of demand growth. Further, if this signals a greater shift for the United States economy, as it often does, law firms may find something far more important than demand threatened — their rates.

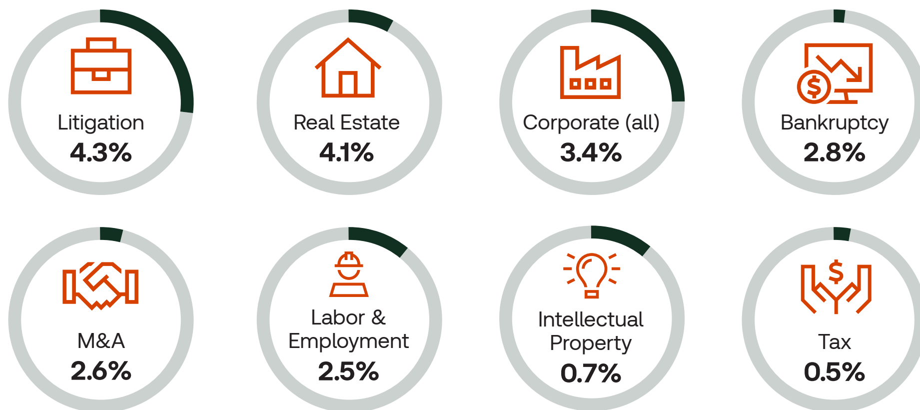
Rate increases have historically been the primary power behind law firm finances, and since the pandemic era, have only become more vital to firm profit growth. Since the end of 2022, a 1 percent increase in worked rate growth has been correlated to more than a 0.9 percentage point increase in profits.

continued

Practice demand growth

Y/Y Change | Q4 2025 vs. Q4 2024

Circular band surrounding practice is equal to proportion of hours worked in 2025.

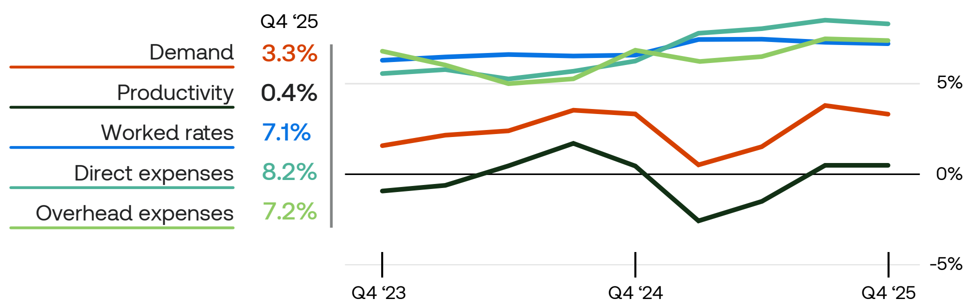


Source: Thomson Reuters 2026

LFFI key factors

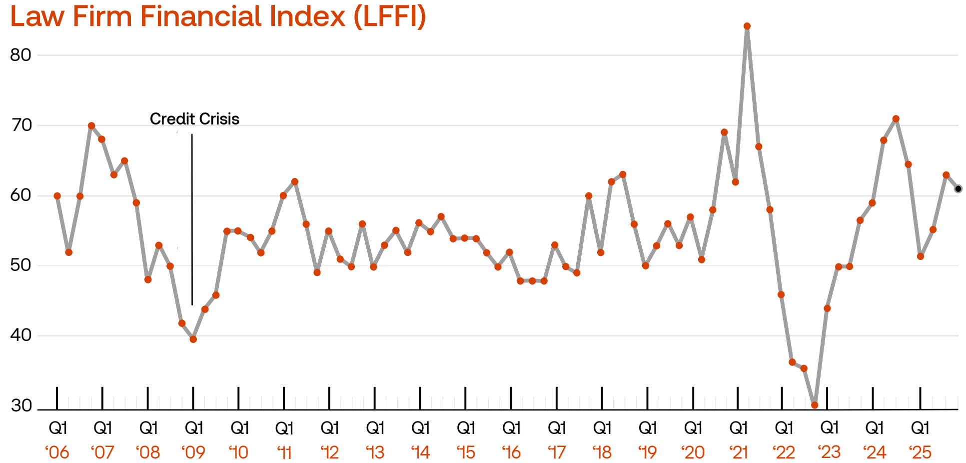
LFFI SCORE: 61

Y/Y Change | Q4 '25 vs. Q4 '24



Source: Thomson Reuters 2026

Law Firm Financial Index (LFFI)



Source: Thomson Reuters 2026

Thomson Reuters Institute

One reason 2025 was so profitable is that law firms broke through a two-decade old rate increase threshold, scoring on average 7% growth in worked rates.

Where things may become less comfortable, however, is the increasing potential for client push-back. As of this report's publishing, 2026's rate increases are already in effect and are expected to be as strong — if not stronger — than 2025's increases. Legal buyers' budgets, to be sure, are under more pressure than ever, especially as counter-cyclical work tends to accompany periods of severe economic turbulence. If Q4's trends continue, clients may find their already tight budgets stretched to breaking point.

Luckily for many General Counsels (GCs), they've been accelerating a solution: moving legal work from the most expensive law firms to lower-priced alternatives. However, if the legal industry continues raising rates at this pace without delivering corresponding value, it's only a small step from clients shifting work to cheaper firms to moving more work in-house. Indeed, Thomson Reuters data indicates many corporate legal departments already are ahead of their outside law firms in GenAI adoption and leveraging AI-augmented strategies.

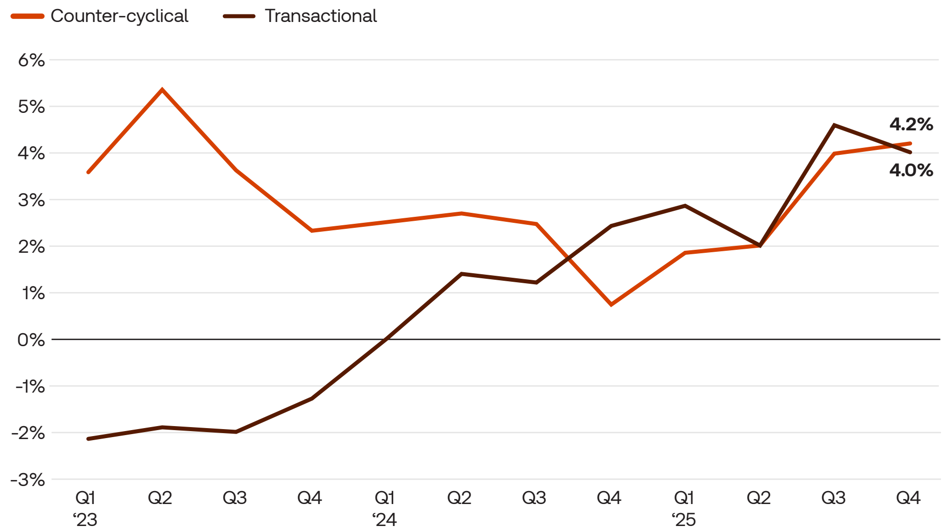
We've seen this movie before, in 2008, and the result was a stagnant decade of law firm growth. The possibility of this repeating should not be discounted, especially as the early acts of a transactional burst being subsumed by counter-cyclical work eerily mirror that earlier situation.

The good news is that none of this spells immediate trouble. While the winds may have shifted for the future, they only did so once firms had effectively locked in their revenues for the year. While expense growth throughout the year held high for law firms, the fourth quarter saw direct and overhead expenses ticked down ever-so-slightly. Direct expenses grew by 8.2% in Q4 2025 compared to Q4 2024,

continued

Weekday-adjusted demand growth

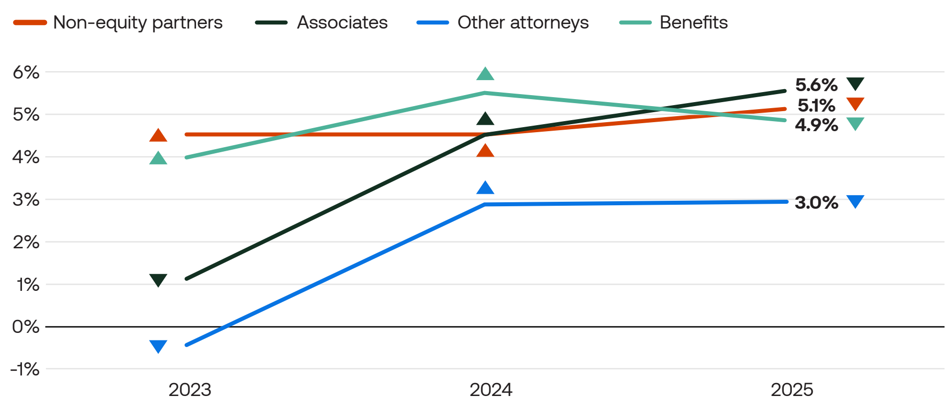
Y/Y Change



Source: Thomson Reuters 2026

Slowdown in direct expenses

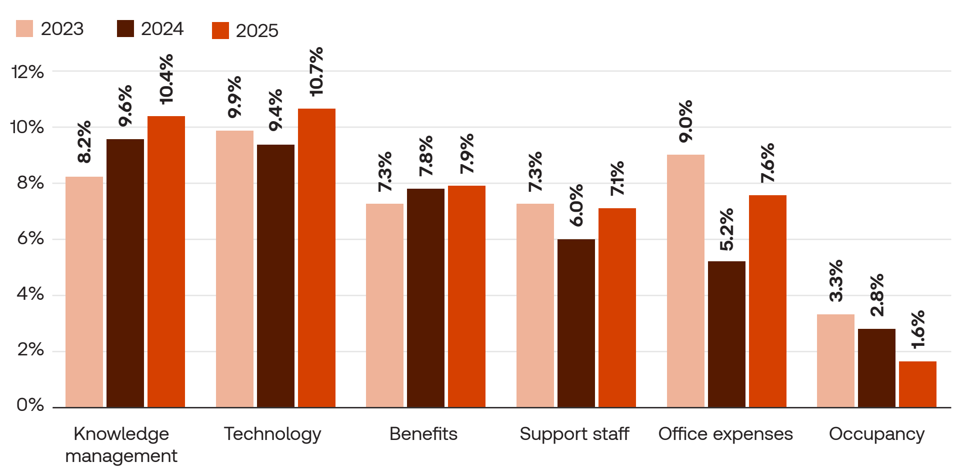
Y/Y Rolling 12-month growth (inflation adjusted)



The arrows indicate whether expenses rose or fell from Q3 to Q4. *Source: Thomson Reuters 2026*

Growth in overhead expenses

Y/Y Rolling 12-month change



Source: Thomson Reuters 2026

with overhead expenses a percentage point behind at 7.2%.

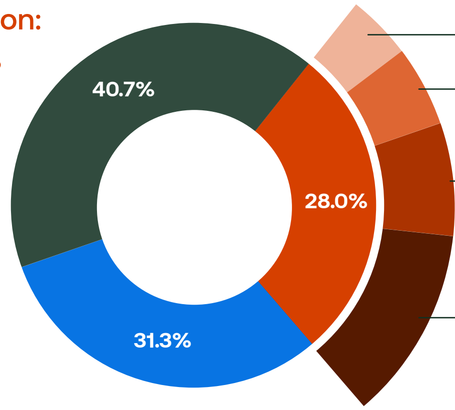
Indeed, direct expenses avoided a surge mainly because 2025's intense bonus payments were measuring against similarly intense 2024 payouts. In this way, the shift in the rolling 12-month metric created a moderating effect as firms also saw serious deceleration in benefits and payments to non-partner, non-associate attorneys.

Not surprisingly, overhead expenses saw continued double-digit growth in competitive areas like technology and knowledge management. However, firms counter-balanced these increases by aggressively suppressing occupancy spending. This category, which includes rent and office ownership expenses, represents 5.1% of an average firm's revenue, which is more than all the technology and knowledge management spending combined. Growing at just 1.6%, below inflation, occupancy spending has effectively shrunk for three consecutive years, helping firms afford the war for tech and talent that has dominated industry headlines.

Combined with firms' strength in rates and demand, this helped law firms cruise to a 14.1% profit increase over the already historically profitable 2024. The average firm's profit margin rose to 40.7% in a year unlike any other.

Law firms ended 2025 in an enviable position — profits were up sharply, margins crested above 40%, and strong demand was safely in the logbook. Yet the final quarter's shifting winds deserve more than a passing glance at the barometer. The deceleration in M&A, resurgence of counter-cyclical work, and mounting pressure on client budgets all suggest that the conditions that propelled firms through a very successful 2025 may not hold indefinitely.

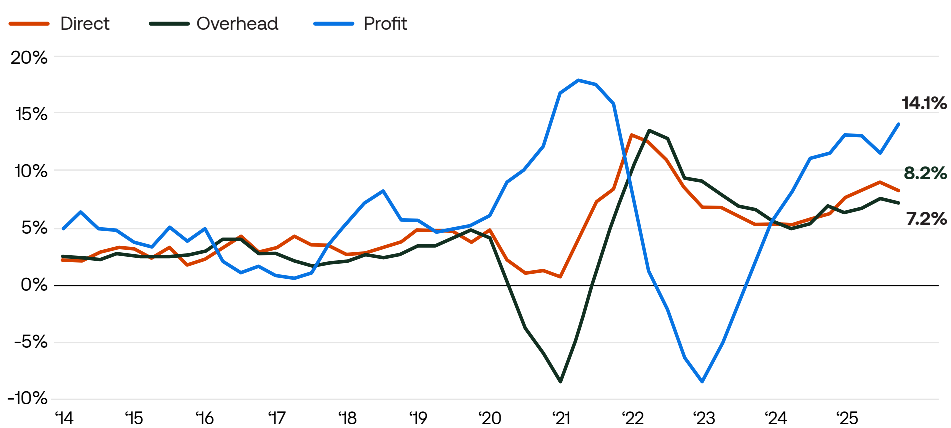
Revenue allocation: direct expenses, overhead and profit margins



Source: Thomson Reuters 2026

Expense and profit growth

Y/Y Rolling 12-month change | All segments



Source: Thomson Reuters 2026

For now, firms have time on their side. Occupancy discipline and moderating expense growth have bought them some breathing room, while rate increases continue to flow largely unchallenged into the bottom line. However, the lessons of 2008 loom large: When clients feel squeezed, they find alternatives — and today's GCs are better equipped than ever.

A downturn isn't destiny, but all lawyers know it's better to prepare for and manage risk than to just assume it will go away. Those firms best positioned for whatever weather lies ahead will be those treating this moment not as a victory lap, but as a chance to lock in efficiency gains and demonstrate value, ensuring that when the next wind shift comes, they're positioned not just to survive, but to thrive.

1 Transactional practices are those that tend to thrive during periods of economic expansion. For the purposes of this report, the transactional practice group is composed of corporate general, mergers & acquisitions (M&A), banking & finance, real estate, and tax.

2 Weekday-adjusted growth figures control for the impact of structural differences in year-over-year demand figures, *smoothing* out noise in the data to capture the *real* changes in demand.

3 Counter-cyclical practices are those that typically rise as other portions of the economy slow and include litigation, bankruptcy, and labor & employment.

This report utilizes information from the Thomson Reuters Financial Insights competitive intelligence platform. For additional details on the data underpinning these reports or to uncover the latest granular and tailored information on the large law firm industry, please contact Bryce Engelland at Bryce.Engelland@thomsonreuters.com or visit the customer support website.

Thomson Reuters Institute