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# Economic value of English law

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## Foreword

LegalUK was set up in 2017 by the Lord Chief Justice, as a group that is committed to encouraging, internationally, the wider use of English law and UK dispute resolution.

Our purpose is to promote English law as the principal platform that underlies global trade, as the governing law of choice for international business, and as a national asset of the UK. We commissioned Oxera to identify the economic value of English Law to the UK. This, we believe, is the first time such research has been undertaken. The report establishes that English law is of value well beyond the legal sector. In fact, English law annually underpins hundreds of trillions of pounds of business activity nationally and internationally.

We thank all the funders of the report, as well as all experts who were consulted as part of the research process.



**Dame Elizabeth Gloster, Chair,  
LegalUK**

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## Summary

**English law underpins most contracts and transactions made within the UK, and many outside the UK. However, the value of English law (as it applies to business transactions) to society as a whole, as opposed to the legal services sector, has not been examined before.**

English Law is a key part of what makes the UK an attractive place to do business for internationally mobile activity and underpins a vast amount of economic activity both in the UK and globally (e.g. English law likely governed at least \$11.6tn of global metals trading in 2020). However, English law's role as a national asset and its wider commercial importance are not fully appreciated or exploited by the UK.

### How does the law generate economic value?

It is a well-established economic principle that value is created through transactions: I focus on what I am good at and then trade with you for the things that you are good at, and—in this way—we are both better off than we would be otherwise. Law, and the legal systems that administer that law, provide predictability and confidence around such transactions. This lowers transaction costs and increases the volume and complexity of the transactions that can take place. In this way, the law supports the creation of economic value. Law is therefore a critical platform on which other economic activity rests.

One of the remarkable facets of English law is the extent to which it is the international standard for contracts in many internationally mobile markets. This internationally mobile standard creates a range of economic benefits to the UK, contributing to the location of the cluster of international businesses located in the UK (including parts of the UK that have a different domestic law), reducing transaction costs for UK firms trading internationally, and building the UK's international influence.

### Are we taking the value generated from English law for granted?

Due to the globalisation and digitisation of business models, an increasing proportion of transactions and contracts are now internationally mobile—i.e. their governing law and the jurisdiction to which they are subject are chosen by those transacting based on their attractiveness to those parties.

Historically, English law has been a popular choice of governing law for many types of internationally mobile transactions. In 2019, it governed around £250bn of global mergers and acquisitions, and 40% of global corporate arbitrations.

The development of new areas of the economy (such as fintech and green bonds), and the recent establishment of international commercial courts across the EU, for example, provide opportunities and risks for English law's status as a global standard for internationally mobile transactions.

Success in these markets is particularly important because many markets have a tendency to 'tip' to one governing law, due to the benefits of using standardised contracts: for example, the International Swaps and Derivatives Association's (ISDA) Master Agreements went from having a range of English, New York and Japanese law prior to 2018 to primarily being governed by English law for EU/EEA counterparties since then. A failure to invest in English law therefore gives rise to major risks for the UK economy.

The most successful platforms of the 21st century have been digital platforms, and their value is directly related to the size of their user base. However, English law suffers from a market failure known as the free-rider problem where no entity acts as the 'platform operator' to grow the user base of English law and maximise the benefits. Such a 'platform operator' should invest in growing the user base and consider how to monetise the value of the platform. This can be delivered through a combination of technological, judicial, professional and industry expertise, alongside government involvement.

### Where next?

Oxera's research leads to several challenging questions for the legal industry and UK government.

1. Which organisations either in the private or public sector should coordinate efforts in nurturing and strengthening this asset for the benefit of the UK as a whole?
2. Who should take responsibility for ensuring that English law be promoted as an international business platform and that the UK is well placed to take advantage of new opportunities?
3. What would be the best form of investment in English law that can appropriately reflect the significant value that English law brings to the UK?

# 1 Introduction

Oxera has been commissioned by LegalUK to identify the economic value of English and Welsh law (referred to in the rest of this report as ‘English law’) to the UK. Law in general, and English law specifically, provides significant benefits to society over and above its economic value, such as establishing and maintaining standards, upholding fairness, and facilitating social change. However, in this report, we focus on the economic value that English law—specifically as it relates to business contracts and transactions—brings to the UK.

English law underpins most contracts and transactions made within the UK, as well as many contracts and transactions outside the UK. The use of English law as the global standard in many parts of the global economy is one of the main reasons for the success of the legal services sector in the UK. However, English law’s role as a business platform and market infrastructure is overlooked and highly significant. English law provides a global platform for the trading, financial and commercial contracts on which global business relies. In addition, it provides an infrastructure for the development of new products and services, and this in turn draws internationally mobile transactions to the UK. From this perspective, English law (among many other factors such as language, time zone, and history) plays a key role in making the UK, and London in particular, one of the pre-eminent global business hubs.<sup>1</sup>

Despite its significant role in the UK and international commerce, there has never (so far as we know) been an attempt to outline the economic value of English law to the UK or the opportunities that future developments might provide. This study seeks to address this gap in our understanding.

English law is often one of the first governing laws in the world to deal with complex market issues and is typically able to find solutions relatively quickly. Through the building of precedent as the first-mover advantage, English law has become a global market standard in many industries and sectors. This status of English law in turn strengthens the UK’s position as a leading hub for developments in complex legal issues. This leads to a ‘network effect’,<sup>2</sup> whereby English law is used more and more, and the benefit gained by those who use English law (i.e. corporations and financial institutions) grows with the total number of users. Moreover, UK businesses benefit from the concentration of expertise in the law underpinning the economy; this concentration has ‘agglomeration effects’, increasing productivity of legal services. As a result, the widespread international use of English law increases UK businesses’ competitiveness, and results in reduced transaction costs for UK firms trading internationally.

The position of English law as a global standard in many parts of the world economy means that risks can arise from competing jurisdictions and the use of governing laws other than English law. Increasing digitisation and globalisation means that an increasing proportion of transactions and contracts are internationally mobile, where parties are free to choose a particular governing law and legal services that best suit their requirements from

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<sup>1</sup> For some examples of other factors, see TheCityUK (2020), ‘[Key Facts about the UK as an international finance centre 2020](#)’, December, p. 10.

<sup>2</sup> A platform experiences network effects when the attractiveness of using the platform depends on the level of participation of other users. Where an additional user of a platform increases the value of using that platform for other users or groups of users, economists call this a ‘positive network externality’.

anywhere in the world. These trends may have significant impacts on the economic value of English law to the UK in the future.

Opportunities to increase the value of English law lie in its application as the main governing law in new markets that are seeing high growth and will continue to do so in the future. This is where the strengths of English law in providing both flexibility and predictability could play an important role in establishing its position as the global standard in these new areas of the economy. Promoting the use of English law in fintech, for example, fits particularly well with the UK government's overall strategy to attract more technological innovations into the financial services sector and to 'cement the UK's position as the world's pre-eminent financial centre'.<sup>3</sup> The flexibility and predictability offered by English law, along with a supportive regulatory environment, can serve as a strong foundation for high growth in the fintech sector. More broadly, there is potential for English law to take the lead in many emerging sectors and industries (for example, in sustainable investing, smart contracts, and artificial intelligence).

This report takes a different approach from previous studies, which have quantified the direct economic contribution of the UK legal services sector.<sup>4</sup> Here, we focus on the broader assessment of how English law contributes to the UK economy. For the obvious reason that nobody owns the law and nobody is employed by the law, previous approaches adopted in this area (which often involve counting the number of people employed in a sector, establishing the wages they earn and the profits they generate) would not work. A different approach is required: one that begins by considering how economic value is created and how the law supports that process.

Our approach is to examine the ways in which English law creates economic value for the UK through drawing on relevant economic literature and a number of examples. This enables us to be clear on why law, and English law specifically, creates economic value for the UK (sections 2 and 3); to quantify the value of several examples of internationally mobile transactions underpinned by English law (section 4); and to assess the potential risks and opportunities for the future value of English law to the UK economy (section 4). By structuring our assessment in this way, we can then clearly identify and examine the fundamental economic characteristics of law that create economic value (section 5), and accordingly pose fundamental questions about how that value can be maximised for the UK in the future (section 6).

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<sup>3</sup> UK Chancellor of the Exchequer Rishi Sunak's announcement of new plans to boost fintech at UK Fintech Week, 20 April 2021.

<sup>4</sup> For example, see TheCityUK (2020), '[Legal excellence, internationally renowned: UK legal services 2020](#)', November; KPMG (2020), 'Contribution of the UK legal services sector to the UK economy', January.

## 2 How does the law deliver economic value to society?

- The law, in general, adds value to society. However, there is no established framework for assessing the economic value of the law, rather than the legal services sector. It is therefore necessary to start by asking what the economic characteristics of the law that create economic value are.
- Economic value is created through the ‘gains from trade’ made possible by transactions between businesses, organisations and individuals.
- The law (as it applies to business transactions) provides economic value by underpinning growth in such transactions by promoting greater confidence between parties.
- The law is a vital piece of infrastructure on which economic activity occurs.

### 2.1 Introduction

The law, in general, adds value to society. Despite the differences in their approaches,<sup>5</sup> all types of governing law are likely to provide some benefit to society through the same underlying mechanisms. In this section, we assess how the law in general can deliver economic value to society.<sup>6</sup> In section 3, our focus turns to how English law benefits the UK economy.

There is no established framework for assessing and describing how the law itself, rather than the legal services sector, contributes to the wider economy. Accordingly, it is important to begin by identifying the way in which the law creates economic value in society.

This section is structured as follows.

- Section 2.2 describes how economic value is created through transactions.
- Section 2.3 explains how the law underpins growth in transactions.
- Section 2.4 describes how the law is a form of global business infrastructure.

### 2.2 Economic value is created by ‘gains from trade’—realised through transactions

Economic value is created when individuals, businesses or organisations transact with each other. Specialisation allows businesses to focus on producing specific goods or services, based on what they are better at. Put another way, parties can be made better off if they exchange something that they are relatively better at producing for something that the other party has the

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<sup>5</sup> For examples of the literature considering differences between common law and civil law, see La Porta et al. (2008), ‘The economic consequences of Legal origins’, *Journal of Economic Literature*, **46**:2, pp. 285–332; and Mahoney, P. (2001), ‘The common law and economic growth: Hayek might be right’, *The Journal of Legal Studies*, **30**:2, pp. 503–25.

<sup>6</sup> As mentioned in the introduction, the law, and English law specifically, provides significant benefits to society over and above its economic value. This includes establishing and maintaining standards, upholding fairness, and facilitating social change. However, the focus of this report is on the economic value that English law—specifically as it relates to business contracts and transactions—brings to the UK.



‘comparative advantage’ in.<sup>7</sup> For example, the production of a car will involve designing the car, building the engine, and adding in many other components. However, the same firm is (in general) unlikely to be sufficiently specialised in the production of all elements of a car to be able to design and manufacture these within the same organisation as successfully as (i.e. to the same quality or at the same price) if they traded with firms who specialise in a particular activity. Therefore, firms (and individuals) specialise and trade between themselves to meet each other’s needs.

This specialisation leads to a more efficient allocation of resources since people and businesses focus on areas in which they can be most productive. As a consequence, there is an increase in productivity throughout the economy (for instance, as businesses and people become more skilled in particular activities), and total economic output correspondingly increases.

Such specialisation, however, will only occur if businesses can trade their surplus output in exchange for other goods and services. These ‘gains from trade’ are realised through transactions.

### **2.3 The law underpins growth in the volume of transactions (and therefore the generation of economic value)**

For transactions to take place, there must be a level of trust between the parties, and some degree of confidence about what will happen if something goes wrong.

When there is uncertainty surrounding a potential transaction, parties will price in the risk of that uncertainty, leading to higher transaction costs. In turn, this means that fewer transactions are likely to occur.<sup>8</sup> The law provides a degree of predictability and confidence to enable transactions to take place by providing a set of common rules that once generally understood and considered to be enforceable through the legal system,<sup>9</sup> give greater certainty about what will happen under specific conditions. This gives a degree of confidence in the enforceability of contracts (which are the legal instruments underpinning transactions). This in turn provides a reduction in the level of uncertainty surrounding a potential transaction, and thus lower transaction costs. Ultimately, this results in more transactions that enable and drive economic value.<sup>10</sup>

**Therefore, the law adds economic value by increasing predictability of outcomes and hence growth in the volume of transactions in an economy.**

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<sup>7</sup> The original ideas of ‘division of labour’, ‘comparative advantage’ and ‘gains from trade’ are generally attributed to the classic works of Adam Smith and David Ricardo. These concepts continue to underpin the academic rationale behind trade between countries—e.g. see DfIT (2020), [‘Final Impact Assessment of the Agreement between the United Kingdom of Great Britain and Northern Ireland and Japan for a Comprehensive Economic Partnership’](#), section 5.1.

<sup>8</sup> See, for example, Williamson, O.E. (1985), *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, Free Press, New York; and North, D.C. (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge University Press.

<sup>9</sup> In this study, we define a legal system as the combination of: (i) the framework that defines and enforces rights and obligations; (ii) the institutions, organisations and individuals defining and enforcing the law; and (iii) the organisations and individuals providing services in relation to the law.

<sup>10</sup> Examples from the academic literature of the effect of contracts or legal protection on economic development are provided by Pablo Casas-Arce and Albert Saiz (2007), who find that costly enforcement of rental contracts hampers the development of the rental housing market in a cross-section of countries, and Jun Qian and Philip E. Strahan (2007), who find that better creditor protection lowers interest rates that lenders charge.

## 2.4 Considering the law as infrastructure on which transactions take place

One way to conceptualise the way in which the law creates economic value by underpinning transactions is to think of the role of *infrastructure* in supporting economic activity. Broadly defined, infrastructure is a set of systems and facilities that support the operation of individuals, businesses, and society as a whole.<sup>11</sup> In supporting and enabling wider economic activity, physical and virtual infrastructure generates economic value.

Thought of in this way, it is clear that the law is a critical infrastructure that enables and encourages the growth of economic value through an increase in business transactions. Contracts and their enforceability through the legal system (including a robust dispute resolution system) give parties confidence to enter into transactions. As such, the law that governs contracts and transactions provides the infrastructure under which parties can transact.

To illustrate this point further, consider rail infrastructure—a large network of bridges, tunnels, tracks and stations. This directly generates economic value through the operation and maintenance of the railways (analogous to the legal services sector's relationship to the law). However, the wider value emerges from the role that the rail infrastructure plays in enabling transactions in other parts of the economy. Goods can be moved over long distances between cities and countries. Individuals can travel to work or conduct business. Thus, the infrastructure supports transactions across the entire economy, enables economic growth, and generates significant value for the UK.

Indeed, the domestic rail network is estimated to have generated up to £29.3bn in value for the UK economy in 2014.<sup>12</sup> This includes £14.3bn in value directly from rail and freight services. Reduced congestion generated £12.9bn in overall benefits, and transport cost savings led to an increase in output of £400m. Finally, agglomeration effects arising from businesses and employees locating in clusters near rail links enhanced the productive potential of the economy by £1.7bn.

Many other examples of infrastructure exist, such as payment systems, broadband and freight networks. These are pieces of critical infrastructure that are vital to a well-functioning economy and upon which many businesses have been built. For all of these types of infrastructure, their economic value is not defined by the number of people they employ or the profits that they generate; it is the economic activity that they facilitate that is the real source of value: without these pieces of infrastructure, there would be increased costs of doing business, reducing the number of transactions happening, and whole industries that rely on the infrastructure to operate would not exist.

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<sup>11</sup> For example, the UK government describes national infrastructure as comprising 'networks, systems, sites, facilities and businesses that deliver goods and services to citizens, and support our economy, environment and social well-being'. See Cabinet Office (2010), '[Section A: Introduction, definitions and principles of infrastructure resilience](#)', para. 2.2.

<sup>12</sup> Oxera (2015), '[What is the contribution of rail to the UK economy?](#)', September.

## Box 2.1 Value created by infrastructure

The UK freight system plays a critical part in supporting economic activity, transporting raw materials and intermediate products to producers and retailers, and allowing demand for goods to be met. It is estimated that the domestic UK freight system transported 1.4bn tonnes of freight in 2017, supporting £400bn in manufacturing sales.<sup>1</sup>

High-quality broadband networks are another example of an integral piece of infrastructure for modern-day economies, providing users with communication services, data transmission and access to information. The UK government's Superfast Broadband programme connected 5m UK premises to superfast broadband,<sup>2</sup> generating £1.7bn in benefits from faster, more reliable broadband between 2010 and 2016.<sup>3</sup> This included productivity gains of £690m, and gains of £38m from a reduction in unemployment. The social value of improved quality of life due to faster and more reliable broadband was estimated to be £932m.

Note: <sup>1</sup> Vivid Economics (2019), '[The value of freight](#)', April. <sup>2</sup> This extended UK superfast broadband coverage to 95% of UK premises. <sup>3</sup> Department for Digital, Culture, Media and Sport (2018), '[Evaluation of the economic impact and public value of the Superfast Broadband Programme Final report](#)', August.

Source: Oxera analysis.

**Overall, infrastructure generates significant value for the UK economy beyond the activity related to the infrastructure itself. The rail network generates £29.3bn in value for the UK economy annually. Freight supports almost £400bn in UK sales and GVA annually. Finally, connecting 5m UK premises to superfast broadband generated £1.7bn in additional value for the UK.**

So far, this discussion has focused—in a general way—on how the law creates economic value. We have established the general manner in which the law generates economic value in any society, but the focus must now turn to the more specific question of how English law creates value for the UK economy.

The value of the infrastructure of English law is likely to bring immense benefits to the UK economy, much like better-understood infrastructure such as rail, freight and broadband. A large part of this value is derived from the significant international portability of English law. This is discussed in more detail in section 3.

### 3 The importance of internationally mobile transactions: English law and the UK

- English law generates significant economic value domestically. Beyond that, a large portion of the economic value of English law for the UK is generated through its application in internationally mobile transactions—and this is where a number of risks and opportunities lie.
- This application of English law facilitates the international use of UK legal services and stimulates activity in the UK legal services ecosystem—directly generating value for the UK.
  - Decisions of the English courts on complex market issues, relevant to internationally mobile transactions, contribute to English law being a global market standard in many industries and sectors. This benefits users of English law as there is predictability in the law and the law continuously evolves to reflect the issues that businesses face. This is an example of a **network effect** of English law—the benefit gained by all English law users grows with the total number of users.
  - The use of English law and UK legal services by the international economy create **agglomeration benefits** within the UK, as UK businesses benefit from having easy access to the concentration of expertise in the law underpinning the economy and from increasing productivity of legal services. International transactions, therefore, help grow expertise in the UK that permeates through the rest of the economy, increasing knowledge sharing, productivity and innovation of all UK businesses.
  - The **transaction costs of trading internationally are reduced** for UK businesses due to the widespread global use of English law, increasing the competitiveness of UK businesses.
- The overall value generated for the UK is maximised when internationally mobile transactions are governed by English law, and when UK legal services are used (whether the contract specifies the jurisdiction of the courts of England and Wales, or a UK-seated arbitration). However, there is still benefit to the UK economy when only one of these two things occurs.

#### 3.1 Introduction

In thinking about value, economists usually consider the difference between scenarios (often the ‘factual’—i.e. the observed state of the world—and the ‘counterfactual’—i.e. the state of the world in which the object of interest has changed). In the current instance, the ‘object’ of interest is English law. Under most conceivable states of the world, UK businesses would be likely to use English law for domestic transactions.<sup>13</sup> Therefore, it is likely that English law generates a significant portion of its economic value for the UK through its application in **internationally mobile transactions—transactions in which**

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<sup>13</sup> We note that UK businesses may also use the laws of Scotland and Northern Ireland in domestic transactions—however, the focus of this report is on English law, and specifically on internationally mobile transactions governed by English law.

**parties can choose the law that governs the contract.** This is where many risks and opportunities lie.

The mechanisms through which the use of English law for internationally mobile transactions generates value for the UK are discussed in the following subsections.

- Section 3.2 discusses the value created within the UK legal services ecosystem from the use of English law in internationally mobile transactions. At this stage, it is important to note that the UK legal services ecosystem is a part of the UK economy more broadly, and thus benefits to it should be seen in that light.
- Section 3.3 concerns the value for the UK economy as a whole from the use of English law in internationally mobile transactions.
- Section 3.4 outlines how the value for the UK can vary depending on the choice of law and jurisdiction used for these internationally mobile transactions.

### **3.2 The economic value created through the UK legal services ecosystem**

In this study, we define the UK legal services ecosystem to include the UK legal services sector and the complex network of organisations, individuals and associated activities within the UK economy that support the provision of legal services.<sup>14</sup>

This is a different concept from that of the legal system (defined in footnote 9)—which is a broader concept that incorporates the legal services ecosystem, as well as the law itself. The legal services ecosystem is, however, much broader than law firms and includes in-house counsel and legal teams, providers of expert witness services, litigation funding, lawtech providers, and the like.<sup>15</sup>

We identify two mechanisms through which English law creates value for the UK legal services ecosystem in internationally mobile transactions:<sup>16</sup>

- the use of UK legal services by the international economy;
- the export of English law.

Firstly, the use of English law in internationally mobile transactions supports the use of UK legal services by the international economy. This includes the activities of UK legal services outside of the UK—i.e. the export of UK legal services, as well as the activities of UK legal services within the UK for international entities, such as UK-based dispute resolution for international businesses.<sup>17</sup>

For example, UK legal services may be required for advising, drafting, and negotiating contracts for internationally mobile transactions. Similarly, contracts

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<sup>14</sup> See KPMG (2020), 'Contribution of the UK legal services sector to the UK economy', January, for an analysis of the sectors that provide inputs to the UK legal services sector.

<sup>15</sup> By 'lawtech', we mean methods and technologies that replace or supplement traditional means of delivering legal services. See Law Society (2019), 'What is lawtech?', June.

<sup>16</sup> There are other ways in which the use of English law internationally can generate value for the UK. For example, the use of English law in the development of legal regimes elsewhere in the world would likely employ UK legal services. In this section, and throughout this study, our focus is on internationally mobile transactions as they cover the biggest economic value as illustrated in section 4.

<sup>17</sup> Regardless of the location, a given activity generates value added to the UK economy as long as it serves the international economy/businesses.

governed by English law may stipulate England and Wales in the jurisdiction clause, requiring UK legal services in the event of disputes. Indeed, 77% of UK Commercial Court claims in 2019 involved at least one party outside England and Wales and 43% of claims involved parties all located outside England and Wales.<sup>18</sup> This use of legal services increases the highly specialised expertise of the UK legal services ecosystem.

The use of legal services by the international economy generates significant value for the UK directly—the UK legal services sector generated a trade surplus of £5.9bn in 2019.<sup>19</sup> Additional value is created through the activity of the UK legal services ecosystem, including all organisations and individuals that support the provision of legal services, such as professional services firms and education services.

Secondly, the ‘export’ of English law itself through its use in internationally mobile transactions outside of the UK also generates value for the UK legal services ecosystem.

While the use of legal services by international users results in payment for the services, the export of English law does not result in direct payment to the UK economy. However, decisions of the English courts relevant to often complex internationally mobile transactions result in early solutions to new market problems as they arise. This contributes to the building of precedent under English law, and increases the volume of transactions under English law as it becomes a global market standard in various industries and sectors.<sup>20</sup>

English law being used in internationally mobile transactions allows it to evolve continuously, provides certainty and predictability in the law, and promotes England and Wales as leading locations for developments in complex legal issues. At a time when economies are embracing an increased use of innovative technologies and products, there is a clear need for a widely used law that can stay abreast of legal requirements not confined by physical borders. Therefore, the use of English law leads to a network effect—the benefit gained by English law users (wherever they are located) grows with the total number of users. This network effect is an important economic characteristic of the law to which we return in section 5.

This network effect further stimulates the use of English law in internationally mobile transactions and activity within the UK legal services ecosystem. This further increases the expertise and international competitiveness of the UK legal services ecosystem. These effects operate in a virtuous cycle, delivering benefits to the UK legal services ecosystem (and therefore to the UK as a whole).

### **3.3 The economic value created for the UK as a whole**

The previous subsection considered the value that English law brings to the legal services ecosystem (itself part of the UK economy). However, the export of English law generates significant value for the UK beyond the bounds of the legal services ecosystem. We identify three mechanisms through which the export of English law creates value for the UK and provides the foundations for

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<sup>18</sup> TheCityUK (2020), ‘Legal excellence, internationally renowned UK legal services 2020’, November.

<sup>19</sup> Ibid.

<sup>20</sup> Precedent is a judicial decision that is either binding—i.e. decisions that a court must abide by in its adjudication of a case—or persuasive, such as decisions from courts in other jurisdictions, in subsequent cases involving sufficiently similar facts. See University of Oxford Faculty of Law (N.D.), ‘[Law reports and the doctrine of precedent](#)’.

the development of globally significant UK-based markets such as financial markets and instrument trading.

- English law is often one of the first to provide solutions to complex market issues, driving greater volumes of transactions under English law as a global market standard. This in turn provides certainty and predictability in the law and allows the law to evolve continuously to reflect the issues that businesses face.
- Knowledge sharing through agglomeration effects increases the productivity, innovation and competitiveness of the UK economy.
- The widespread use of English law globally reduces transaction costs for UK businesses trading internationally.

### **3.3.1 English law as a global market standard**

Decisions of the English courts on complex market issues relevant to internationally mobile transactions contribute to the building of precedent under English law. Network effects also play an important role in this process, as we discussed above.

English law has the flexibility to adapt to and solve complex market problems relatively quickly. By providing solutions early in various markets, English law often enjoys the ‘first-mover advantage’ by becoming a global market standard in these areas. This can occur through the establishment and building of precedent, providing further predictability to users of English law. This benefit leads to a greater volume of transactions being governed under English law, encouraging the widespread use of English law in internationally mobile transactions. Indeed, this is a form of network effect—as English law becomes more widely used, businesses are more likely to choose English law in part as it has become a global standard.

Through the building of precedent and the establishment of these global market standards, all English law users, and especially UK businesses, benefit from certainty and predictability in the law and a law that continuously evolves to reflect the issues that they face. Businesses can more easily assess the nature and scope of their legal obligations, be clear about how risk is allocated when the contract is formed, and predict the likely outcome of disputes and judicial decisions. Businesses are able to plan accordingly in light of relevant precedent, and have increased confidence to transact due to this certainty and predictability in the law.

This generates economic value by promoting growth in transactions and increases the domestic competitiveness of all UK businesses, as discussed in section 2.

### **3.3.2 Agglomeration effects**

Further economic value is created through agglomeration effects in the UK legal services ecosystem and the wider UK economy. Agglomeration effects, facilitated by characteristics of the UK economy,<sup>21</sup> allow expertise from the use of English law and UK legal services in internationally mobile transactions to permeate through the economy. All UK businesses benefit from having access to concentrations of highly specialised, expert legal services, as well as from

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<sup>21</sup> These include the clustering of professional services in cities such as London, Birmingham, Manchester and other urban areas in Great Britain. See TheCityUK (2020), ‘Legal excellence, internationally renowned UK legal services 2020’, November.



knowledge sharing and increases in productivity and innovation in those legal services.

Agglomeration effects can generate significant economic value. For example, the agglomeration benefits of being based in London are a key factor in the city's success as a global hub for commercial and professional activities.<sup>22</sup> Proximity to other businesses and access to a highly skilled labour market reduces transaction costs and facilitates knowledge sharing. This leads to higher productivity in the area and significant value for the UK—for instance, London has the highest per capita tax contribution in the UK at £18,195, compared to the UK median of £10,349.<sup>23</sup> London also had the highest average annual growth in tax revenue of all UK regions from 2010 to 2018,<sup>24</sup> possibly reflective of the continuous value generated by agglomeration effects.

### 3.3.3 Reduced transaction costs for UK businesses trading internationally

Finally, UK businesses that trade internationally benefit from the widespread global use of English law through their familiarity with it. The prevalence of English law internationally means that UK businesses are less likely to need to consult lawyers or set up an in-house legal counsel qualified in law other than English law. This reduces the transaction costs of trading internationally, especially for small and medium-sized enterprises, or those that trade in high-volume/low-value products.

Coupled with knowledge spill-overs and productivity increases due to agglomeration, lower transaction costs can increase the international competitiveness of UK businesses. This is likely to increase the level of economic activity that UK businesses can undertake abroad, generating value for the UK.

#### Box 3.1 Why are transaction costs important?

Transaction costs are the total costs of making a transaction—i.e. the costs associated with buying or selling goods or services, such as the costs of discovering market prices, the costs of bargaining, and the costs of writing and enforcing contracts. These costs make transacting more costly and time-consuming.

For example, when transacting, businesses use contracts to specify the obligations of the transacting parties. While contracts and their enforceability enable transactions as discussed in section 2, there is an associated transaction cost. This includes drawing up the contract under the agreed upon governing law. When businesses are able to transact using a governing law that they are familiar with, and which is widely used, transaction costs will be lower than if this is not the case. Businesses may be able to use standard contracts for the majority of their transactions and may be less likely to need legal services when transacting.

Lower transaction costs mean that more transactions are likely to occur, generating economic value.<sup>1</sup>

Note: <sup>1</sup> See, for example, Williamson, O.E. (1985), 'The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting', Free Press, New York; and North, D.C. (1990), 'Institutions, Institutional Change and Economic Performance', Cambridge University Press.

Source: Oxera.

<sup>22</sup> GLA Economics (2016), '[Economic evidence base for London](#)', November.

<sup>23</sup> This is the median tax revenue per person across the Nomenclature of Territorial Units for Statistics NUTS1 regions. This includes all forms of tax. Office for National Statistics (2019), '[Country and regional public sector finances: financial year ending 2019](#)', December.

<sup>24</sup> Oxera analysis based on Office for National Statistics (2019), op. cit.

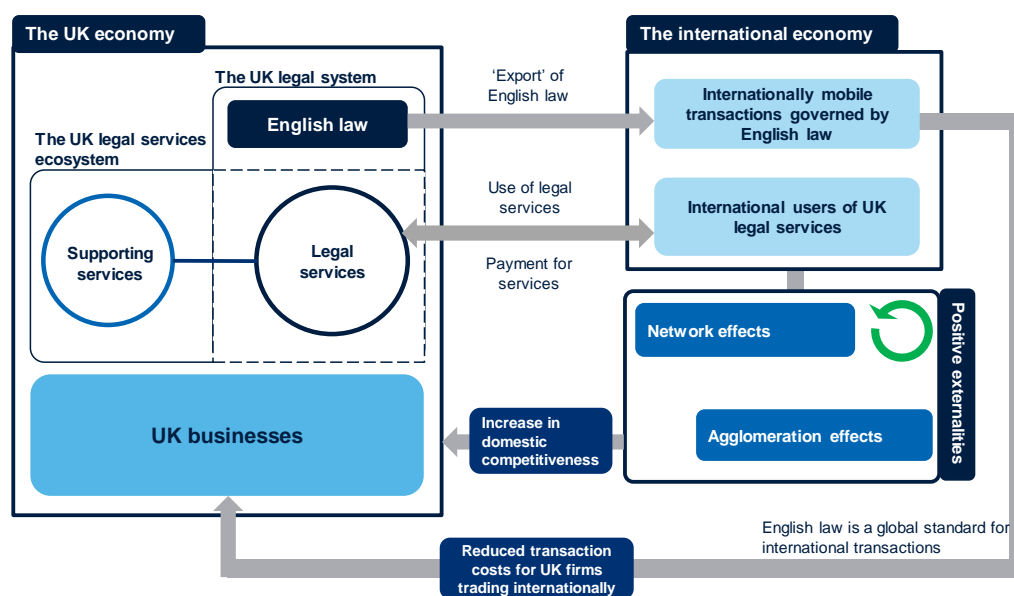


These effects are particularly clear in sectors in which the UK has historically been a global leader and in which English law is commonly used to govern related internationally mobile transactions, such as financial services, maritime, wholesale insurance and reinsurance, and commodity trading. This interaction between the international use of English law, agglomeration effects and international competitiveness continually benefits the UK through a positive feedback loop.

We note that several other factors in addition to the use of English law contribute to the UK's position as a global centre for professional activities (such as the English language and a favourable time zone). It is difficult to distinguish the separate impacts of these various influences; however, each is individually important in contributing to the value brought to the UK economy. In this report, we have not attempted to disentangle these factors; instead, we highlight that English law in particular is one factor that generates significant economic value for the UK but has received relatively little recognition.

Figure 3.1 provides an illustrative summary of the mechanisms through which the use of English law to govern internationally mobile transactions generates value for the UK.

**Figure 3.1 The value for the UK from the use of English law to govern internationally mobile transactions**



Source: Oxera.

The network effects, agglomeration effects and reduced transaction costs of trading internationally all serve to increase the competitiveness of UK businesses. These effects operate in a cycle, delivering benefits to the UK and continuously promoting the use of English law to govern internationally mobile transactions.

### 3.4 The choice of law and legal services for internationally mobile transactions

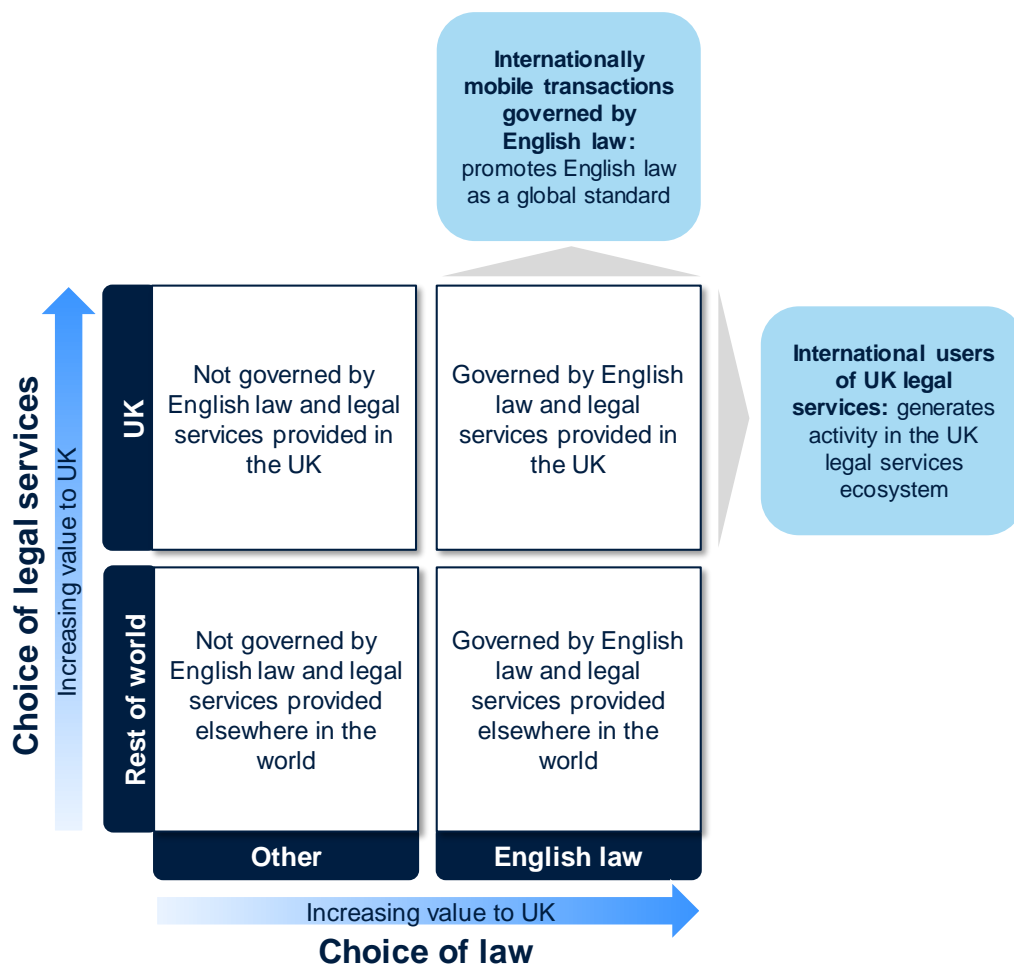
Globalisation, trade and digitisation have enabled an increasing proportion of global transactions to be internationally mobile, allowing parties to choose the law that governs the contract. Whether these internationally mobile transactions involve the use of English law and/or UK legal services will determine the economic value that these transactions bring to the UK.

The value generated for the UK through the mechanisms discussed in sections 3.2 and 3.3 above will be maximised when both:

- internationally mobile transactions are governed by English law;
- UK legal services are used when the jurisdiction of the courts of England and Wales or a UK-seated arbitration are specified in the contract.

The figure below illustrates how different choices of law and the use of legal services deliver value to the UK economy in a number of ways.<sup>25</sup>

**Figure 3.2 Value for the UK from internationally mobile transactions**



Source: Oxera.

As presented in the bottom left corner of the figure above, when a transaction is neither contracted under English law nor using UK legal services, it does not generate any value for the UK. On the opposite corner (top right), transactions can be governed by English law and employ UK legal services: these provide the greatest value for the UK. In other cases, some transactions may be governed under English law without using UK legal services (see the bottom right-hand corner of Figure 3.2). At the same time, internationally mobile transactions that do not currently use English law offer opportunities to the UK (for example, foreign law-governed transactions adjudicated in English courts and UK-seated arbitrations, and foreign-seated arbitrations where legal

<sup>25</sup> 'Legal services' here includes dispute resolution when England and Wales is specified in the jurisdiction clause of the contract or UK-seated arbitration is specified.

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services are provided either in the UK or abroad by UK lawyers and arbitrators).

In the next section, we explain and quantify the economic value of internationally mobile transactions governed by English law in four examples concerning: (i) the maritime sector; (ii) commodity trading; (iii) 'International Swaps and Derivatives Association' (ISDA) swaps and derivatives; and (iv) the insurance sector. We then consider several potential areas where English law could be used to govern internationally mobile transactions in the future, representing significant opportunities to generate value for the UK economy.

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## 4 Towards an economic valuation of English law

- English law is a popular choice of governing law for many types of internationally mobile transactions. Many sectors of the UK economy account for large volumes of internationally mobile transactions governed by English law. For instance, English Law was selected as the most frequently used governing law by 43% of 600 survey respondents, and was often used in transactions with little or no other link to the UK.<sup>26</sup> Similarly, it is estimated that **English law comprises 40% of all governing law in global corporate arbitrations.**<sup>27</sup>
- Global trade tensions may pose a risk to the use of English law internationally. We use four examples to illustrate a portion of the value of internationally mobile transactions governed by English law and the potential value to be gained or at risk from competition. In each case, stylised calculations demonstrate the scale of internationally mobile value.
  1. **Maritime sector.** English law governs the majority of global commercial maritime contracts. The UK maritime sector as a whole has been estimated to contribute up to **£17bn** annually to the UK economy. A 30% reduction in maritime-related business services transactions governed by English law could lead to a loss to the UK GDP of approximately **£1.2bn**. A 5% growth in this market could lead to a gain to the UK economy of approximately **£200m** per year.
  2. **Commodity trading.** In 2020, English law likely governed at least **\$11.6tn** of global trading in metals (besides other commodities such as oils, fats, and grains). A 30% movement elsewhere of transactions on the London Metal Exchange would entail a reduction in trading value of **\$3.5tn**. A 4% growth in global non-ferrous metals trading could represent an **additional \$464bn** in annual trading value.
  3. **ISDA swaps and derivatives.** English law likely governed at least **€661.5tn** of global OTC derivatives trading in 2018. Impacts from Brexit have led to a reduction in average UK daily turnover of OTC euro interest rate swaps from **\$367bn** in July 2020 to **\$92bn** in January 2021 (corresponding to a decrease in market share from 40% to 10% for the UK in euro interest rate swaps). If 50% of lost euro denominated interest rate swaps transactions were to relocate back to the UK, average daily turnover would **increase by \$137.5bn**.
  4. **Insurance.** English law governs many insurance and reinsurance contracts globally, and governs the majority of the **£80bn** of gross written premium in the London Market. If 30% of insurance activity currently in the UK market were to move elsewhere, this could represent a loss of **£24bn** in gross written premium and an impact on GDP of approximately **£7.5bn** per year. If there were to be a 5% increase in activity in the UK market, this could represent a benefit to the UK economy of over **£1bn**.
- The use of English law has been one of the drivers of the position of the UK as a location for internationally mobile transactions, including in these four examples. These examples serve to illustrate the value of

<sup>26</sup> Singapore Academy of Law (2019), 'Study on governing law & jurisdictional choices in cross-border transactions', April.

<sup>27</sup> TheCityUK (2020), 'Legal excellence, Internationally renowned UK legal services 2020', November.

internationally mobile transactions underpinned by English law in those sectors. In addition, there are many other examples where English law governs internationally mobile transactions with significant value—for instance, the total value of global mergers and acquisitions (M&A) deals governed by English law was approximately £250bn in 2019.<sup>28</sup> Other examples include the construction sector, energy contracts, and bond issuance. A ‘true’ value of English law would include some of the value from each of these varied sectors. Indeed, the value of English law to the UK economy is likely to be far greater than the sum of these individual parts, due to agglomeration and network effects (as discussed in section 3) that we have not attempted to quantify for this report.

- Many **opportunities** exist for the use of English law to expand in existing and new addressable markets, and to play an important role in market developments such as the emergence of cryptoassets, fintech and sustainable investing. In these emerging fields, there is likely to be great value in providing a leading business platform and global market standard—i.e. the first-mover advantage.

#### 4.1 Introduction

Due to the globalisation and digitisation of business models, an increasing proportion of transactions and contracts are internationally mobile, where parties are free to choose a particular governing law and legal services that best suit their requirements.

Interviews we have conducted with stakeholders have highlighted several aspects of English law in relation to business—for example, increased predictability, certainty, and flexibility, which make it a popular choice of governing law for many types of internationally mobile transactions.

For example, a 2019 survey of over 600 legal practitioners and in-house counsel involved in cross-border transactions in Asia found that English law was selected as the most frequently used governing law by 43% of respondents, and was often used in transactions with little or no other link to the UK.<sup>29</sup> Similarly, it is estimated that **English law comprises 40% of all governing law in corporate arbitrations globally.**<sup>30</sup>

The choice of English law has become a standard—either officially or unofficially—for contracting in a number of areas since it provides compatibility across transactions and ensures ease in further transactions.

In section 3 above, we discuss the mechanisms through which the use of English law to govern internationally mobile transactions generates economic value for the UK. In section 4.2, we study four examples that display the value of internationally mobile transactions that are governed by English law. This illustrates the value of international activity that is underpinned by English law.

However, competition from other jurisdictions promoting their own legal systems, and increasing global trade tensions, such as those associated with Brexit, could pose a risk to English law’s status as a global standard for internationally mobile transactions.

<sup>28</sup> Oxera analysis based on data provided by Allen & Overy, and Dealogic (2020), ‘Value of merger and acquisition deals worldwide in 2019, by region’.

<sup>29</sup> Singapore Academy of Law (2019), ‘Study on governing law & jurisdictional choices in cross-border transactions’, April.

<sup>30</sup> TheCityUK (2020), ‘Legal excellence, Internationally renowned UK legal services 2020’, November.

Despite this, there is also significant future value available from the use of English law across various new markets. Thus opportunities to promote the use of English law internationally should be seized: this is discussed in section 4.4.

This section is structured as follows.

- Section 4.2 highlights some of the value of internationally mobile transactions governed by English law through four examples:
  1. the maritime sector (section 4.2.1);
  2. commodity trading (section 4.2.2);
  3. ISDA swaps and derivatives (section 4.2.3);
  4. insurance contracts (section 4.2.4).
- Section 4.2.5 then summarises the potential significance of the value of English law to the UK economy and some emerging competitive risks.
- There are potential risks to the widespread use of English law and to the associated benefit to the UK economy, discussed in section 4.3. However, further growth of existing markets where English law is widely used and the prevalence of the use of English law in those markets also presents an opportunity to increase the value for the UK.
- Section 4.4 sets out the further opportunities for English law to bring additional value to the UK economy in emerging sectors, markets and products.

## **4.2 English law provides significant value to the UK economy**

To illustrate the value of internationally mobile transactions governed by English law, we use four examples from a range of sectors in the UK economy. In particular, we focus on the maritime sector (section 4.2.1), commodity trading (4.2.2), swaps and derivatives (4.2.3), and insurance markets (4.2.4). As we discuss in section 3.3.1 above, English law serves as a market standard, contributing to the UK's position as a leading location for these internationally mobile transactions.

Besides English law, there are other factors that contribute to the UK's position as a global centre for professional activities. We do not attempt to disentangle these factors, and instead look at the value of internationally mobile transactions governed by English law in prominent UK sectors as an illustration of the global significance of English law and its value for the UK. The four examples discussed are only a subset of the types of internationally mobile transactions that are governed by English law globally. Stakeholder engagement highlighted many other examples including in the construction industry, energy power purchase agreements (PPAs), insolvency and bond issuance, among other markets and sectors. Therefore, while the value highlighted through the examples in this section is significant, it will represent only a small portion of the overall value of English law for the UK economy. It is also important to note that while the UK gains the most economic value from these business activities if some parts of the transactions are governed by English law and physically located within the UK borders, there is also value from transactions under English law taking place elsewhere, as discussed in section 3.

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Where international changes may pose a risk to English law's status as a global standard for internationally mobile transactions, there is value at risk for the UK economy associated with the mechanisms discussed in section 3. A reduction in internationally mobile transactions governed by English law could reduce the volume of precedent derived from international cases decided under English law and the building of expertise throughout the legal system. If English law were no longer a global standard for internationally mobile transactions, the benefit gained by users would decrease as the number of users falls through negative network effects and it might be more difficult to attract lost activity back to the UK.

If English law were no longer a global standard for transacting internationally, UK businesses may be required to transact internationally under a governing law other than English law more often, increasing transaction costs. As explained in Box 3.1, transaction costs serve only to make transacting more costly and time-consuming, reducing the volume of transactions that businesses undertake. English law's position as a global standard to govern many internationally mobile transactions affords UK businesses a comparative advantage through their familiarity with the law. This reduces transaction costs for UK businesses as they are less likely to need to use legal services advising on laws other than English law and may be able to use standard contracts for many of their transactions. Risks to the use of English law to govern internationally mobile transactions may lead to an increase in transaction costs.

#### 4.2.1 Maritime sector

The maritime sector comprises various interlinked industries such as shipping, ports, and marine and maritime business services. It covers the transportation of freight and passengers, the physical building of vessels, and the operation of ports. It also includes a large industry of maritime business services, from shipbrokers to finance providers and insurers. Many of these activities are internationally mobile, though currently the UK is the leading global maritime hub, and English law is the leading choice for shipping and associated commercial contracts.

The UK maritime sector as a whole has been estimated to contribute between £14bn and £17bn of direct gross value added (GVA) annually to the UK economy.<sup>31,32</sup> The UK has a large industry supplying business services to the maritime sector, which contributes approximately £4bn to the UK economy.<sup>33</sup> Many of these businesses provide services to international clients, and thus many of their transactions can be considered to be internationally mobile transactions. We provide more detail on the maritime sector in section A1.1.

The maritime sector particularly benefits from business 'clustering' due to the widespread use of sub-contracting and outsourcing, and the application of highly specialised skills.<sup>34</sup> The UK, and London in particular, has become a global hub of international maritime services.

There are many reasons for the success of the UK as a global maritime centre that attracts a large proportion of internationally mobile transactions. One important attraction of the UK maritime cluster is the widespread use of English

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<sup>31</sup> Eddings, G., Chamberlain, A., Colaco, H. and Philips, I. (2020), '[The Shipping Law Review: United Kingdom – England & Wales](#)', June.

<sup>32</sup> Maritime UK (2019), '[State of the maritime nation report 2019](#)', September.

<sup>33</sup> CEBR (2017), 'The economic contribution of the UK Maritime Business Services industry', September.

<sup>34</sup> For a more detailed analysis of the competitiveness of the UK maritime sector and a discussion of 'clusters' in this industry, see Oxera (2015), '[International competitiveness of the UK maritime sector](#)', May.



law. Indeed, English law is the preferred legal framework for global commercial maritime contracts. As a report published by the City of London Corporation notes:<sup>35</sup>

Use of English law and UK arbitration internationally for maritime business is a cornerstone of the UK's strength in maritime law.

The widespread use of English law as the industry standard in maritime contracts across the globe has historically given the UK an advantage and 'unrivalled legal and judicial expertise'.<sup>36</sup> However, as other regional hubs seek to expand in the coming years, risks to the use of English law and the UK's status as a global maritime hub may increase.

If competition were to cause UK maritime business to move elsewhere and possibly be governed by a law other than English law, this would represent a significant loss to the UK. A stylised illustration of potential impacts identifies the following.

- A 10% reduction in UK maritime business could mean a loss to the UK economy of approximately **£400m each year**.
- A reduction of 30% in UK maritime business could lead to a **loss of approximately £1.2bn to the UK each year**.

Due to the agglomeration effects described above, a reduction in size of this important part of the maritime cluster could have a much wider effect in the long run.

Nevertheless, there exist opportunities for the UK to promote English law in maritime transactions as the sector continues to expand globally. Continued success of English law would enable the UK maritime cluster to further attract internationally mobile transactions. For instance, if the UK maritime business sector were to expand by 5%, this could represent an **additional £200m** for the UK economy.

#### 4.2.2 Commodity trading

Commodities are undifferentiated goods often used as inputs in the production of other goods and services.<sup>37</sup> The sale and purchase of commodities is regularly carried out on commodities exchanges worldwide, where trading is governed by standard form contracts issued by exchanges and trade associations. The UK is home to a number of trade associations, such as GAFTA, FOSFA and RSA,<sup>38</sup> and commodities exchanges including the London Metal Exchange (LME).

Trading on LME platforms totalled \$11.6tn in 2020—making the UK the world centre for non-ferrous metals trading.<sup>39</sup> Similarly, estimates suggest that 85% of the global trade in oils and fats is traded under FOSFA contracts,<sup>40</sup> and 80% of the global trade in grains is traded under GAFTA contracts.<sup>41</sup>

<sup>35</sup> PwC (2016), op. cit., p. 21.

<sup>36</sup> See: <https://www.maritimeuk.org/about/our-sector/maritime-business-services/> (last accessed 5 May 2021).

<sup>37</sup> Examples of commodities include agricultural products, metals and crude and refined oil.

<sup>38</sup> Grain and Feed Trade Association (GAFTA). The Federation of Oils, Seeds and Fats Association (FOSFA). The Refined Sugar Association (RSA).

<sup>39</sup> London Metal Exchange (2020), '[Guide to the London Metal Exchange](#)'.

<sup>40</sup> FOSFA International (N.D.), '[FOSFA International: About us](#)'.

<sup>41</sup> GAFTA (N.D.), '[Membership](#)'.



The standard form contracts offered by GAFTA, FOSFA, RSA, and the LME are governed by English law.<sup>42</sup> Therefore, **English law likely governed at least \$11.6tn of global metals transactions, approximately \$92.4bn of global oils and fats transactions,<sup>43</sup> and \$98.2bn of global grains transactions in 2020.<sup>44</sup>**

Given the current prevalence of GAFTA and FOSFA contracts in commodities trading globally, there is likely minimal risk to the use of these contracts and thus the use of English law in these transactions. However, for UK-based commodity exchanges such as the LME, global competitive risks<sup>45</sup> may pose a risk to trading volumes and the use of English law in these transactions. For example, as of 1 January 2021, the LME is no longer deemed to be an equivalent trading venue under EU law, which has the potential to introduce additional regulatory obligations for EEA counterparties and UK counterparties trading with EEA counterparties.<sup>46</sup> This could increase transaction costs and reduce the volume of trading on the LME and the use of English law to govern these transactions.<sup>47</sup> Stylised calculations suggest the following.

- If 10% of transactions on the LME moved elsewhere, annual trading value governed by English law could fall by around **\$1.2tn**.
- A more severe loss of 30% could entail an annual reduction in trading value governed by English law of around **\$3.5tn**.

A reduction in the use of English law to govern these transactions will reduce the value generated for the UK through the mechanisms discussed in section 3. The movement of these transactions may also reduce the additional value generated through the UK commodities trading ecosystem as associated activities are shifted to other global centres, discussed further in section A1.2.

On the other hand, if non-ferrous metals trading on the LME grew by 4% in line with estimates for the increase in steel demand,<sup>48</sup> this could represent an **additional \$464bn** in annual trading value governed by English law.

### 4.2.3 ISDA swaps and derivatives

A derivative is a contract, the value of which is based on an underlying financial asset, index, or security. Derivatives can be traded on securities exchanges with standardised contracts, or can be traded over the counter (OTC), often using the ISDA master agreement.<sup>49</sup>

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<sup>42</sup> The rules and procedures for the arbitration services offered by GAFTA, FOSFA, RSA and the LME are also drawn up under the framework of English law. GAFTA (N.D.), '[All Contracts](#)'; LME (2021), '[London Metal Exchange Rules and Regulations](#)', 18 March; RSA (2021), '[Rules and Regulations](#)', 2 March; FOSFA (N.D.), '[Contracts](#)'.

<sup>43</sup> Total global trade in oils and fats was \$108.7bn in 2020. United Nations (N.D.), '[UN Comtrade Database](#)'.

<sup>44</sup> Total trade in cereals was \$122.8bn in 2020. United Nations (N.D.), '[UN Comtrade Database](#)'.

<sup>45</sup> This could include implications for the LME from Brexit as well as competition from other metals exchanges worldwide—for example, COMEX located in the USA, and the Shanghai Futures Exchange (located in China).

<sup>46</sup> LME (2021), '[LME Brexit Factsheet](#)', January.

<sup>47</sup> Where commodities are traded on exchanges elsewhere, transactions are likely to be governed by a law other than English law. For example, contracts and arbitration services offered by the Shanghai Futures Exchange in China are written in accordance with the law, regulations and judicial interpretations of the People's Republic of China. Shanghai Futures Exchange (N.D.), '[General Exchange Rules of the Shanghai Futures Exchange](#)'.

<sup>48</sup> Estimates suggest that global steel demand is estimated to grow by 4.1% in 2021. See worldsteel Association (2020), '[worldsteel short range outlook October 2020](#)', 15 October.

<sup>49</sup> An umbrella agreement setting out standard contract terms between parties trading OTC derivatives. The ISDA Master Agreement contains the parties' choice of governing law of the contract and includes a provision specifying the jurisdiction that can adjudicate upon disputes between parties. See Thomson Reuters Practical Law (N.D.), '[ISDA Master Agreement](#)'.

The size of the global OTC derivatives market is vast. For example, OTC interest rate derivatives are the most commonly traded derivative globally, with an annual turnover of \$2,679tn in 2019.<sup>50</sup> The UK is a global hub for derivatives trading, accounting for 50% of global OTC interest rate derivative activity in 2019.<sup>51</sup> Similarly, 82% of all European derivatives trading involved a UK domiciled counterparty in 2019.<sup>52</sup>

Prior to 2018, ISDA offered English, New York and Japanese law-governed Master Agreements.<sup>53</sup> According to ISDA,<sup>54</sup> ‘virtually all’ ISDA Master Agreements entered into between counterparties based within the EU or the EEA were governed by English law in 2018.

### **English law likely governed at least €661.5tn of global derivatives transactions in 2018.<sup>55</sup>**

However, in July 2018, ISDA published the Irish and French law-governed Master Agreements to provide parties with the option to trade under the law of an EU member state.<sup>56</sup> While it is not yet clear if there has been a reduction in the use of the English law-governed Master Agreement, global trade tensions, such as Brexit, may pose a risk to the UK’s position in global derivatives trading and the use of English law to govern derivatives contracts.<sup>57</sup>

Data suggests that the risk of the movement of these internationally mobile transactions has already begun to materialise in the OTC euro denominated interest rate swap market.<sup>58</sup>

- The UK had a 40% market share of the euro interest rate swap market in July 2020, while the market share of both the EU and the USA was 10%.<sup>59</sup>
- After the UK–EU Trade and Cooperation Agreement was signed on 30 December 2020, the UK’s market share in euro interest rate swaps fell to 10% in January 2021. The EU’s market share increased to 25% and the USA’s market share to 20%.<sup>60</sup>

The daily average turnover of OTC euro interest rate swaps was approximately \$917bn in 2019,<sup>61</sup> implying that **UK average daily turnover fell from \$367bn in July 2020 to \$92bn in January 2021.**

<sup>50</sup> Bank for International Settlements (2019), [‘Triennial Central Bank Survey of Foreign Exchange and Over-the-counter \(OTC\) Derivatives Markets in 2019’](#).

<sup>51</sup> Ibid.

<sup>52</sup> European Securities and Markets Authority (2020), [‘EU Derivatives Markets ESMA annual Statistics Report 2020’](#).

<sup>53</sup> ISDA (2018), [‘Brexit and the ISDA Master Agreement’](#), 8 January.

<sup>54</sup> ISDA (2018), [‘ISDA Publishes French and Irish Law Master Agreements’](#), 3 July.

<sup>55</sup> Data for 2018 European OTC derivatives transactions from European Securities and Markets Authority (2019), [‘EU Derivatives Markets ESMA annual Statistics Report 2019’](#), 9 December.

<sup>56</sup> This allows for the retention of specific benefits of EU legislation and allows EU/EEA counterparties to retain automatic recognition and enforcement of judgements when trading with each other. ISDA (2018), [‘ISDA Publishes French and Irish Law Master Agreements’](#), 3 July.

<sup>57</sup> We note that if, for example, the EU demands on-shoring of derivatives trading in the future, the promotion of English law to govern derivatives transactions will not stop the loss of these transactions. However, this example serves to highlight the fact that these transactions are internationally mobile and the publication of the Irish and French law-governed Master Agreements indicates that there may be a risk of English law being replaced by others to govern derivatives transactions in the EU.

<sup>58</sup> We note that this data is for Euro denominated interest rate swaps, which may be expected to be severely affected by Brexit. Thus this data is not representative of changes in alternatively denominated interest rate swaps or other derivative products.

<sup>59</sup> IHS Markit (2021), [‘2021: Brexit, no equivalence for pan European OTC Interest Rate Swaps markets, what the data shows so far...’](#), 10 February. This market share data is for all OTC single currency (euro in this case) interest rate swaps.

<sup>60</sup> Ibid.

<sup>61</sup> Bank for International Settlements (2019), [‘Triennial Central Bank Survey of Foreign Exchange and Over-the-counter \(OTC\) Derivatives Markets in 2019’](#).

The movement of these transactions to other global financial centres may decrease the value generated for the UK throughout the whole UK derivatives market ecosystem.<sup>62</sup> This is discussed further in section A1.3. A reduction in the use of English law to govern these transactions will further reduce the value generated for the UK through the mechanisms discussed in section 3.

However, there may be opportunities for English law in existing financial markets and as new financial products come to market and gain popularity. As a stylised example, if 50% of lost euro denominated interest rate swaps transactions were to relocate back to the UK, this would represent a **\$137.5bn increase** in average daily turnover.

Opportunities for English law in new and emerging markets, such as in sustainable finance, are discussed in section 4.4.

#### 4.2.4 International insurance contracts

Insurance products provide protection against a vast array of different types of risk exposure, ranging from retail customers insuring their cars or homes, to complex areas such as cyber risk or space risk for commercial clients.<sup>63</sup> Such risk is underwritten through insurance contracts.<sup>64</sup> Much of this business, along with many associated supporting services, is internationally mobile in nature. The insurance sector as a whole is one of the largest contributors to UK GVA, accounting for approximately £30bn per year.<sup>65</sup>

The UK insurance industry comprises life insurance, general retail insurance, and commercial insurance. We focus in particular on those parts of the insurance sector where contracts are especially internationally mobile.<sup>66</sup> In particular, we consider the 'London Market' as a large cluster of insurance providers and support services that provide for specialty insurance and reinsurance for international corporate clients.<sup>67</sup> The London Market is the leading global insurance hub, accounting for approximately £80bn in gross written premium in 2018.<sup>68</sup> The London Market accounted for £15bn in direct GDP contribution in 2018, rising to £26bn when including indirect contributions.<sup>69</sup>

One reason why London is attractive in this sector is that it has traditionally been an innovative market, with market participants working to write risks and continually develop new products. London has therefore established a long-standing reputation as the world's leading centre for insuring specialty risk. The widespread use of English law in internationally traded insurance contracts is another important factor behind the economic value that the insurance market brings to the UK. English law is chosen to govern many insurance and reinsurance contracts globally.

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<sup>62</sup> For example, clearing houses such as the London Clearing House and ICE Clear Europe, which provide clearing and settlement services for trades, could see activity move elsewhere in Europe or globally.

<sup>63</sup> See Lloyd's of London, '[What we insure](#)'.

<sup>64</sup> The 'insurance' value chain comprises significant reinsurance and retrocession markets, as well as direct insurance. These distinctions are explained in further detail in section A1.4—in this section, we refer to 'insurance' as encompassing each of these elements.

<sup>65</sup> ABI (2019), '[The state of the market 2019](#)', p. 6.

<sup>66</sup> We provide more detail on the market of internationally traded insurance contracts in section A1.4.

<sup>67</sup> The London market comprises Lloyd's (a highly specialist market that insures large-scale complex risks), and the Companies Market (which includes international insurance companies with operations in London). The risks that are written are not only UK-based—indeed, a large part of the business involves overseas risks.

<sup>68</sup> London Market Group (2020), '[London matters 2020](#)', p. 9.

<sup>69</sup> *Ibid.*, p. 17.

After London, the next largest insurance hubs globally are Bermuda, Zürich and Singapore. Although London remains the largest market, recent years have seen faster growth for the Bermuda and Singapore markets.<sup>70</sup>

In addition, as trade in some markets shifts to new regions (e.g. growing global container flows in Asia), demand for insurance may follow since a large share will remain insured locally (e.g. Asia may become the largest market for marine cargo insurance).<sup>71</sup> In turn, this may lead to an increase in the global use of insurance contracts not under English law. To demonstrate the potential scale of the impacts, we consider some stylised scenarios.

- If 10% of international insurance activity currently in the London Market were to move elsewhere and possibly be governed by a law other than English law, this could represent **£8bn in gross written premium** and an impact on GDP of approximately **£2.5bn per year**.
- A 30% reduction in UK international insurance activity from the London Market would involve losing £24bn in gross written premium, and **£7.5bn loss to the UK economy**.

However, there are many new developments and innovations within the insurance sector that offer opportunities for continued growth of business in the UK market and under English law. Markets may expand and market shares grow and/or return. Potential new developments may include cyber risks, privacy concerns around the use of biodata, and climate change, as well as ever-evolving technologies.<sup>72</sup> There is therefore great potential for the future use of English law in internationally mobile insurance transactions to generate significant value for the UK economy. For instance, if there were to be a 5% increase in activity in the London Market, this could represent **more than a £1bn benefit** to the UK economy per year.

#### 4.2.5 The value of English law to the UK economy is significant

As we set out in section 4.1, for the purpose of this study, we have examined four examples in detail. These serve to illustrate the potential value for the UK economy that is underpinned by English law in those sectors, giving us multiple perspectives on the economic value of English law to the UK. However, in addition to this suite of numbers, there are many other examples we could have chosen where English law contributes significant value. For instance, we calculate that the total value of global mergers and acquisitions (M&A) deals governed by English law was approximately £250bn in 2019.<sup>73</sup> Other examples where English law may be particularly prominent include the construction sector, energy contracts, insolvency, and bond issuance among others.

In each of these examples, a large number of transactions are internationally mobile, and these represent significant economic value. Therefore, the potential value highlighted in the sections above, while already very significant, is likely to account for only a small portion of the total value of English law to the UK economy.

Indeed, the value of English law to the UK economy is likely to be far greater than the sum of these individual parts thanks to agglomeration and network

<sup>70</sup> London Market Group (2020), op. cit.

<sup>71</sup> See, for example, BCG (2014), '[London matters: The competitive position of the London Insurance Market](#)', p. 16.

<sup>72</sup> For example, see IUA (2020), '[Annual review 2019/20: Navigating the changing nature of risk](#)'. Also see Oxera (2020), '[The value of cyber insurance to the UK economy](#)', October.

<sup>73</sup> Oxera analysis based on data provided by Allen & Overy, and Dealogic (2020), '[Value of merger and acquisition deals worldwide in 2019, by region](#)'.

effects (as discussed in section 3.3). In addition, English law is likely to add value through channels we have not attempted to quantify for this report, such as its important role in contributing to maintaining the UK's influence and ability to promote British values.<sup>74</sup> We expand on this further in Box 4.1 below.

#### Box 4.1 English law, global influence and the importance of London

One source of value for the UK that derives from the use of English law internationally is the UK's increased global influence, or 'soft power'.

When the infrastructure of English law is used by a large number of businesses globally, it can, and has, become one important business language. Businesses can, and in many instances do, only 'talk' to each other through legal constructs—i.e. through contracts. In the same way that the English tongue is an important way for individuals to interact internationally (even when neither party is UK-based), English law is one mode through which businesses communicate.

Indeed, discussions between businesses (e.g. around financing, employment, solvency, etc.) will be framed and shaped by the business language available to them. To the extent that English law is this business language for many transactions internationally, it provides the UK with a degree of global influence.

This 'soft power' is likely to draw people and resources to the UK for experience, education, training, and leadership. This further adds to the importance and attraction of the UK (and London in particular) as an international business hub, increasing the benefits from agglomeration as described in section 3.3.2 above.

London is the centre of the UK's economy and is a centre for international business. While it is hard to disentangle the various factors that make London such a successful international business hub, it is clear that it creates a very large amount of value for the UK economy. For instance, as a region, London had the highest net fiscal surplus per head at £4,369 in FYE 2019, with total public sector revenue of £162bn. In terms of GDP, London accounted for £504bn in 2019 (23% of the UK total), at £56,199 per head compared with the UK average of £32,876.

Source: ONS (2021), '[Country and regional public sector finances: financial year ending 2020](#)'; ONS (2021), '[Regional economic activity by gross domestic product, UK: 1998 to 2019](#)'.

#### 4.3 Risks and opportunities

While English law provides significant value to the UK economy through its use in internationally mobile transactions, global trends could pose a risk to English law's status as a global standard for these transactions. For example, while the London Commercial Courts handled a record number of cases in 2020/21 compared to the previous six years, the proportion of litigants from the EU has been steadily decreasing since 2016/17.<sup>75</sup> Only 11.5% of litigants at the London Commercial Courts were from the EU in 2020/21—a notable decrease from 16.5% in 2016/17.<sup>76</sup> Questions around enforcement coupled with the recent establishment of international commercial courts across the EU, including in France, Germany and the Netherlands, may drive some EU litigants to locate disputes in the EU rather than the UK.<sup>77</sup> In addition, New York law—being one of the common laws used globally—may represent a significant alternative in some markets for many of the contracts that underpin internationally mobile transactions—particularly if these transactions involve

<sup>74</sup> Academic research in the sociology and political science literature has discussed various states' political strategies such as in international education: Lomer, S. (2017), '[Soft power as a policy rationale for international education in the UK: a critical analysis](#)', *Higher Education*, 74:4, pp. 581–98.

<sup>75</sup> Portland Litigation and Disputes (2021), 'Commercial Courts Report 2021'.

<sup>76</sup> Ibid.

<sup>77</sup> See Standing International Forum of Commercial Courts (2021), '[Multilateral Memorandum on Enforcement of Commercial Judgments for Money](#)', Second Edition, April, for the enforcement procedures of 33 countries including France, Germany and the Netherlands.



parties located in New York and which may accordingly benefit from being governed by New York law.

There are further examples of potential competition from other jurisdictions around the provision of certain legal services. The recent growth in the number of international arbitrations in the Asia-Pacific region, with international arbitration centres in the region seeing large increases in the number of case filings in recent years, shows the credibility of these risks. The Singapore International Arbitration Centre (SIAC), for instance, saw 1,080 new case filings in 2020, a 125% increase from 479 new case filings in 2019, with a total sum in dispute of over US\$8bn.<sup>78</sup>

Indeed, several jurisdictions have been active in promoting their own legal systems and legal services sector as part of a strategy to attract more international business.<sup>79</sup> For example, Singapore acknowledges that its legal system provides a vital infrastructure for its economy and a major attraction for international transactions in many sectors such as financial services, technology and shipping.<sup>80</sup> This has resulted in various activities being undertaken, such as actively promoting Singaporean law, raising the profile of its legal sector, opening up to foreign lawyers and establishing itself as a major arbitration centre.<sup>81</sup> These are important parts of a broader strategy to increase its attraction as an international business hub.<sup>82</sup>

Therefore, while English law is currently of great value to the UK economy, its use globally in internationally mobile transactions in some areas may be at risk to some degree. However, with the appropriate level of coordinated investment and support, which we discuss in more detail in section 5, English law is well placed to remain a pre-eminent choice globally.

There are also many opportunities for the use of English law to grow. This includes in existing markets (of which examples were provided in section 4.2) as these industries/sectors grow and if the use of English law for these internationally mobile transactions continues to expand. In addition, further opportunities may also exist in new markets and areas. These future opportunities, to which we turn in section 4.4 below, represent significant value that the use of English law can generate for the UK economy.

#### **4.4 Future opportunities for the use of English law represent significant potential value to the UK**

While there may be risks to the use of English law internationally, there are opportunities for English law to expand to other markets. Jurisdictions where English is widely spoken and used officially are the most obvious addressable market for English law to grow into; however, the most value is likely to be

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<sup>78</sup> Singapore International Arbitration Centre (2021), '[SIAC Annual Report 2020](#)'. This is coupled with a decline in the proportion of SIAC cases governed by English law in recent years—9% of all SIAC cases were governed by English law in 2020, down from 21% in 2017. Singapore International Arbitration Centre (2018), '[SIAC Annual Report 2017](#)'. Regardless of the precise governing laws used in these cases, such growth in other jurisdictions may represent a potential loss of value to the UK as new legal hubs emerge and provide competition to the UK.

<sup>79</sup> We note that in some cases these legal systems may be based, at least in part, on English law (for example, the DIFC in Dubai). In such 'hybrid' models English judges and English lawyers may be used to work on some cases, demonstrating the mobility of English law and legal services.

<sup>80</sup> See, for example, Committee on the Future Economy (2017), '[Report of the Committee on the future economy](#)', February, Appendix SC2.1.

<sup>81</sup> For example, see Singapore Academy of Law (2021), '[About Us: Introduction](#)' (last accessed 10 May 2021); SAL (2020), '[Report on the right of appeal against international arbitration awards on question of law](#)', pp. 15–9. Ministry of Law (2017), '[15 recommendations to strengthen Singapore as a global leader for legal and accounting services](#)', April.

<sup>82</sup> See, Committee to review the regulatory framework of the Singapore legal services sector (2014), '[Final report](#)', p. 6.

generated where the existing law does not have a significant body of precedent or the approach to law leads to significant uncertainty. We have seen several examples of this where new regimes were created based on English law. This leads to economic value for the UK through the mechanisms that we set out in section 3. Furthermore, it is important for the UK to capitalise on its strong and longstanding position in specific areas, such as capital markets, insurance, and shipping.

Further opportunities lie in the application of English law as the main governing law to new areas that are seeing high growth and which will continue to do so in the future.<sup>83</sup> This is where the strengths of English law in providing flexibility and predictability play an important role to maintain and further establish its position as the global standard. One example of this is the recent work by the UK Jurisdiction Taskforce—one of six taskforces of the 'LawTech Delivery Panel', which includes industry experts and members from the government and judiciary.

In May 2019, the UK Jurisdiction Taskforce (UKJT) published its public consultation paper on the status of cryptoassets, distributed ledger technology, and smart contracts under English private law.<sup>84</sup> The consultation paper considers the legal status of cryptoassets and, in particular, whether the law treats them as property,<sup>85</sup> as well as the legal status of smart contracts and particularly whether smart contracts should be treated as contracts for legal purposes.<sup>86</sup> In its subsequent 'Legal statement on Cryptoassets and Smart Contracts', the UKJT states that in general, cryptoassets are to be treated in principle as property and smart contracts are capable of having contractual force.<sup>87</sup> This has been followed by the publication of digital dispute resolution rules for resolution of smart contract disputes either by English-seated arbitration or expert determination.<sup>88</sup>

Where perceived legal uncertainty in relation to these assets is a reason for a lack of confidence among some market participants and investors, the well-developed common law system of England and Wales has been able to adapt to deal with such fast-changing technologies and is well positioned to provide a sound legal foundation for their development.<sup>89</sup> Indeed, the principles set out in the 'Legal statement on Cryptoassets and Smart Contracts' have been tested and adopted in the English courts, and have been approved and referred to in other common law jurisdictions.<sup>90</sup>

While cryptoassets are still small compared to traditional financial assets, the use of smart contracts and distributed ledger technology (DLT) on which smart contracts and cryptoassets are based has much wider application, and these are likely to have significant impacts on our society and economy in the future.

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<sup>83</sup> Similar to the four examples we have discussed so far, there is value for the UK from new areas using English law when the business activities physically take place in and/or outside the UK.

<sup>84</sup> UK Jurisdiction Taskforce (2019), '[UKJT Consultation paper The status of cryptoassets, DLT and smart contracts under English private law](#)', 9 May.

<sup>85</sup> Note that it is difficult to formulate a precise definition of a cryptoasset and, given the rapid development of the technology, that would not be a useful exercise. The term 'cryptoasset' is used to refer generally to assets of some kind that have to be represented digitally. See UK Jurisdiction Taskforce (2019), 'Legal statement on cryptoassets and smart contracts', 19 November, p. 13.

<sup>86</sup> There is a contract in English law when two or more parties have reached an agreement, intend to create a legal relationship by doing so, and have each given something of benefit.

<sup>87</sup> UK Jurisdiction Taskforce (2019) 'Legal statement on cryptoassets and smart contracts', 19 November.

<sup>88</sup> See UK Jurisdiction Taskforce (2021), '[Digital dispute resolution rules](#)', UK Jurisdiction taskforce,

<sup>89</sup> The UK Jurisdiction Taskforce (2019), 'Legal statement on cryptoassets and smart contracts', November, p. 4.

<sup>90</sup> In the English courts, see, for example, *AA v Persons Unknown* (2019) EWHC 3556 (Comm) (Bryan J at p. 57–61). The principles have also been adopted in New Zealand in *Rusco v Cryptopia Ltd (in Liquidation)* (2020) NZHC 728 at p. 102 (Gendall J), and were referred to in *Singapore in Quoine Pte Ltd v B2C2 Ltd* (2020) SGCA(I) 02 (Menon CJ).

Their use is likely to grow rapidly in the coming years—PwC estimates that the total assets under management of crypto hedge funds globally increased to nearly US\$3.8bn in 2020 from US\$2bn the previous year.<sup>91</sup> There is therefore likely to be substantial value to the UK in ensuring that English law is at the forefront in competing for these new internationally mobile financial instruments and transactions.

Promoting the use of English law in fintech fits particularly well in the government's overall strategy to attract more technological innovations in the financial services sector and to 'cement the UK's position as the world's pre-eminent financial centre'.<sup>92</sup> The UK fintech sector generated £6.6bn in revenue and employed 76,500 people as of the first half of 2020,<sup>93</sup> and is a rapidly growing market globally, with €156bn in capital invested in fintech globally in 2019 (up 130% from four years previously).<sup>94</sup> The predictability and flexibility offered by English law, high quality of judges and of UK legal professionals in general, along with a supportive regulatory environment, can serve as the strong foundation for high growth in the fintech sector.

Similar to fintech, another example of new areas that English law can take a lead on is sustainable, or ESG (environmental, social, and governance), investing. Demand for sustainable finance is expected to continue to grow substantially over the coming decades—for example, annual global issuance of green bonds was estimated to be \$290bn in 2020,<sup>95</sup> up from just \$42bn in 2015.<sup>96</sup>

Currently, the most debated topic in this area is the lack of standardisation in reporting and ESG scoring. This leads to asymmetric information between investors and companies, and thus may be an opportunity for English law to provide further clarity and predictability, in the form of either standardised private contracts specifically for ESG or ESG laws/regulation.

The UK is already a prominent global leader in green finance—according to the latest Global Green Finance Index published by Z/Yen, London was rated the world's number 3 green finance hub.<sup>97</sup> The position and global influence of the UK further bolsters the opportunities for English law in sustainable financing and investing.

Indeed, these and other future developments and markets are likely to grow rapidly, much like the growth of the derivatives and securitisation markets in the 1990s where English law has enjoyed the first-mover advantage due to its early solutions to key market issues. It has since become an asset generating great economic value for the UK economy. However, this value is not static, and looking forward, there is scope for significant growth in the value that English law can help to generate for the UK economy.

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<sup>91</sup> PwC (2021), '[3rd Annual Global Crypto Hedge Fund Report 2021](#)', May.

<sup>92</sup> UK Chancellor of the Exchequer Rishi Sunak's announcement of new plans to boost fintech at UK Fintech Week, 20 April 2021.

<sup>93</sup> TheCityUK (2020), '[Key Facts about the UK as an international finance centre 2020](#)', December.

<sup>94</sup> Deloitte (2020), '[Fintech On the brink of further disruption](#)', December.

<sup>95</sup> Climate Bonds Initiative (2021), '[Sustainable debt Global state of the market 2020](#)', April.

<sup>96</sup> Climate bonds initiative (2016), '[2015 Green bond market roundup](#)'.

<sup>97</sup> Z/Yen (2020), '[The Global Green Finance Index 6](#)', 27 October.



## 5 Key considerations in managing and promoting the role of English law

- English law suffers from a ‘free-rider problem’, which leads to an ‘under-provision’ of English law compared to the socially optimal level of investment that is consistent with maximising the benefits that English law brings to the UK economy. This reduces the extent to which the UK maximises the overall benefits of English law.
- Coordinated action across different sectors of the economy, as well as with the government, is required to achieve the biggest impacts in promoting the use of English law. Several areas require further discussion between the private sector and the government to effectively manage English law in a way that maximises the economic value for the UK economy from this national asset.

### 5.1 Introduction

As we discussed in section 2, English law—as with any other legal system in the world—is an infrastructure on which transactions take place. English law, however, is notable for the extent to which it is used not only in domestic transactions occurring within the UK, but also in internationally mobile transactions. English law was and is the global standard in many types of transactions across the world from sectors including commodities, shipping and some areas of financial services. As has been shown in this report, this results in significant economic benefits for the UK. English law is therefore an important national asset for the UK. However, there has been little recognition of this and little concerted effort to consciously maintain and promote this asset for the benefit of the UK as a whole.<sup>98</sup>

In this section, we explore the key considerations relating to the management and strengthening of the asset that is English law, especially for internationally mobile transactions.

This section is structured as follows.

- Section 5.2 discusses the market failure from which English law suffers and the consequences resulting from the free-rider problem.
- Section 5.3 presents and illustrates (with examples) considerations from economic theory on dealing with the free-rider problem.
- Section 5.4 draws from economic theory to propose a solution in the context of English law specifically.

### 5.2 English law suffers from a type of ‘market failure’

So far, this report has set out the significant economic benefits that English law brings to the UK, outside the legal services sector, by serving as an essential infrastructure to facilitate transactions in the economy.

Similarly to other types of infrastructure, English law is likely to suffer from ‘market failure’—i.e. a situation where society as a whole can be made better off if provision is not entirely left to private parties within the market (see Box

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<sup>98</sup> We discuss the role of industry bodies—the Bar Council and the Law Society—in promoting English law to non-UK audiences in section 5.4.

5.1 for a more detailed explanation). This problem arises because once a private party makes an effort to promote English law, all English law users—including both the legal services sectors, the businesses they serve, and the wider UK economy—will benefit from that effort without having to pay for it. The problem of those who benefit from resources or services of a communal nature<sup>99</sup> but do not pay for them or under-pay is called **the ‘free-rider’ problem**.

### Box 5.1 The economics of ‘market failure’

The term ‘market failure’ is used by economists to describe a situation where a market will under- or oversupply certain goods or services relative to the socially optimal level, leading to sub-optimal outcomes. The term therefore refers to how a market performs relative to a hypothetical benchmark widely used in the economics literature, and is not a reflection of the commercial success of legal service providers.

Conceptually, a market where there are many firms (so no single firm can influence the price level significantly), no transaction costs (through perfect knowledge and information), homogeneous (i.e. the same) products, no externalities (i.e. the decisions of one firm or consumer do not have an impact on the welfare of other firms or consumers), and no barriers to entry can result in an economically efficient allocation of resources. However, there are many situations where this may not be the case—for instance:

- when it is difficult for a private market to produce public goods efficiently due to the free-rider problem;
- when the existence of externalities means that the full social costs and benefits are not fully reflected in market prices.

In such cases, markets can lead to an inefficient allocation of resources (relative to the socially optimal benchmark).

In other words, these are situations where society as a whole can be made better off when the provision of a good or service is not left solely to a market. Therefore, this term refers to a ‘failure’ of the market to allocate resources in an economically efficient way. Economists use this concept to understand how markets function and it should not be taken to mean that any particular market is performing ‘well’ or ‘badly’.

Source: Oxera.

Another way to look at the market failure that English law exhibits is that there is **a positive externality coming from the use of English law—i.e. the benefits enjoyed by the wider UK economy from English law are beyond the benefits for the UK legal services sector**.

A free market that works efficiently is expected to result in an optimal level of investment where the marginal cost of the investment equals its marginal benefit for all users. However, due to this positive externality, no private party—in this case, either within or outside the legal services sector—can capture all of the benefits enjoyed by the whole UK economy from the promotion of English law. Indeed, as the legal services sector receives only a part of the benefits generated by English law, the optimal level of investment made by that sector would be likely to fall short of the total benefits. This would then lead to an ‘under-provision’ of English law compared to the outcome without this market failure—i.e. **the socially optimal level of investment** that is consistent with all of the benefits English law brings to the UK economy.<sup>100</sup>

<sup>99</sup> A resource or service of a communal nature is considered a public good if it satisfies two characteristics: non-rivalry (when a good is consumed, it does not reduce the amount available for others), and non-excludability (it is not possible to provide a good without it being possible for others to enjoy it).

<sup>100</sup> Superficially, this free-rider problem as described in the case of English law has some similarity with the ‘tragedy of the commons’ concept. However, there are important differences between the two concepts. ‘Tragedy of the commons’ refers to the overuse/overconsumption of a common resource while the free-rider

This ‘under-provision’ problem is particularly relevant when there is large upfront investment required from a private company. **The lack of incentives from the free market means that there is economic inefficiency—i.e. investments are not made even when the wider social marginal benefits exceed the marginal cost of the investments.**

The economic inefficiency exists here because without sufficient investments to maintain and promote English law, some transactions may move away from English law to other governing laws, reducing the economic benefits that English law can bring to the UK. Perhaps more importantly, increased ‘efficiency’ would allow the UK economy to realise more fully the potential value that is on offer from further opportunities for English law (such as those described in section 4.4).

### 5.3 Solutions to the free-rider problem: coordination across private and public parties

The free-rider problem exists in many different situations. There are different ways to deal with it that have been explored in the economic literature. A key approach to solving the mismatch between private costs and public benefits of an investment is to ensure coordination across private and public parties.

For example, the National Trust is a private charity that works to conserve land and property of national significance.<sup>101</sup> As a charity, the National Trust relies on membership fees, revenue from land and property, and government support to carry out its work.<sup>102</sup> This combination of private ownership and some public support allows land and property of cultural, historical and natural importance to be protected.

One potential solution can be drawn from the role of the government in supporting and coordinating the management of other national assets that generate value for the UK. For example, there are parallels between English law and natural capital—just as English law facilitates economic activity, natural capital provides services that underpin the functioning of the economy (see Box 5.2). The UK government has recognised these issues and started working to protect and promote the value of UK natural capital. For example, 28% of the UK’s land area is protected in some way.<sup>103</sup> Similarly, 25% of UK waters (21.8m hectares) are protected to some degree.<sup>104</sup> In 2020, the government also launched an online resource for measuring natural capital.<sup>105</sup> The tool attempts to improve decision-making by taking into account impacts on the environment and natural capital.

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problem in English law refers to the lack of incentive to invest and supply a good. The free-rider problem in English law, therefore, is more similar to the issues of low R&D funding or investment in infrastructure projects. (The ‘tragedy of the commons’ idea originated in an essay written in 1833 by the British economist William Forster Lloyd, who used a hypothetical example of overgrazing on common land (also known as a ‘common’) in Great Britain and Ireland. It became widely known as the ‘tragedy of the commons’ after an article written by Garrett Hardin in 1968: Hardin, G. (2009). ‘The tragedy of the commons’, *Journal of Natural Resources Policy Research*, 1:3, pp. 243–53.)

<sup>101</sup> These properties and land are of cultural, historical and natural importance and therefore exhibit a positive externality—the benefits for the UK population are beyond the benefits for the owner of these properties and land.

<sup>102</sup> The National Trust (N.D.), ‘[Our acquisitions](#)’.

<sup>103</sup> Joint Nature Conservation Committee (2020), ‘UKBI – C1. Protected areas’.

<sup>104</sup> *Ibid.*

<sup>105</sup> UK government (2020), ‘[Enabling a Natural Capital Approach](#)’, January.

## Box 5.2 Economic value of natural capital

Natural capital is the stock of natural assets including land, vegetation, air, water and all living things.<sup>1</sup> Natural capital provides a range of services that make human life possible, underpinning the functioning of the economy and providing non-economic benefits that contribute to quality of life. This includes meeting human needs such as demand for food and materials; providing recreational and aesthetic services; and the important role that natural capital plays in regulating natural and human environments—for example, carbon sequestration.<sup>2</sup> The annual value generated for the UK by these natural capital services was estimated to be £35.9bn in 2018.<sup>3</sup>

When considering the long-term potential of the UK's natural resources to provide services to the population over the resource's lifespan, the total asset value of UK natural capital was estimated to be £921bn.<sup>4</sup> For example, the total asset value of UK's woodland areas is estimated to be £130bn,<sup>5</sup> and the total asset value of the UK's coastal and marine areas is estimated to be £211bn.<sup>6</sup>

Despite the significant benefit and value of the stock of natural capital, the free market has resulted in overconsumption and underinvestment in these assets in the UK, as well as elsewhere in the world.

Note: <sup>1</sup> World Forum on Natural Capital (N.D.), '[What is natural capital?](#)'. <sup>2</sup> Office for National Statistics (2020), '[UK natural capital accounts: 2020](#)', 19 November. <sup>3</sup> £21.2bn in value was generated through the meeting of human demands; recreational and aesthetic services provided by natural capital are valued at £10.8bn; the regulation of natural and human environments generated £3.9bn in value. Ibid. <sup>4</sup> Office for National Statistics (2020), '[UK natural capital accounts: 2020](#)', 19 November. <sup>5</sup> Office for National Statistics (2020), '[Woodland natural capital accounts, UK: 2020](#)', 28 February. <sup>6</sup> Office for National Statistics (2021), '[Marine accounts, natural capital, UK: 2021](#)', 6 April.

### 5.4 How to manage the 'provision' of English law

So far, in this section, we have drawn upon economic theory to discuss the market failure in the 'provision' of English law. By 'provision', we mean growing the international user base with innovative offerings in new sectors (e.g. fintech and ESG as discussed in section 4.4), increasing market share in existing sectors, and promoting the use of English law for internationally mobile transactions more generally. This can range from raising awareness of the advantages of using English law to investing in and maintaining the already high quality of UK dispute resolution, judges and the judicial system in general, and support for UK-seated arbitration. Indeed, it is important to note that a cornerstone of the provision of English law is the function of an independent judiciary who apply, interpret and create the law. Managing the 'provision' of the law therefore means ensuring that the UK best takes advantage of the opportunities associated with this national asset.

There are two key considerations relating to the management of the 'provision' of English law.

First, promoting the use of English law is particularly important because **English law exhibits a notable network effect—i.e. the benefit gained by English law users grows with the total number of users.**

As more internationally mobile transactions in a specific sector are written under English law, English law then becomes a standard for contracts in that sector. Thus, there is greater incentive for users of that contract to use English law instead of deviating to a different governing law. A standardised contract can increase predictability and confidence between the parties involved and help lower transaction costs.<sup>106</sup> This in turn leads to an increase in the number

<sup>106</sup> The benefits of 'standard setting' have been discussed thoroughly in the context of the role of regulation within the economic literature. An example of this is the mandatory EU technical standard enforced in 1987 called GSM (after the Groupe Spécial Mobile committee) that was adopted globally. The global reach of the

of transactions, compared to the counterfactual without a standardised contract where parties have to choose a suitable governing law, draft and review each contract for every transaction they make.<sup>107</sup>

As a consequence of this dynamic, many sectors with internationally mobile transactions have a tendency to ‘tip’ in the sense that one governing law takes it all or dominates these transactions, due to the benefit from standard setting. As a result, this means that there is a significant incentive for competing governing laws to position themselves as an alternative to English law and to win the market (as we discuss in section 4.3, there is already some competitive pressure to win certain sectors and markets from English law).

### Box 5.3 Another perspective on network effects: digital platforms

There are examples of private actors running markets and infrastructure that exhibit large network effects.

Digital platforms such as Google, Amazon, Apple and Facebook can be considered as part of the infrastructure of the internet and also exhibit strong network effects.

The greater the number of people who use these platforms, the greater the benefits that these users gain, and so the easier it is to attract more users. The strong network effects mean that these markets can tip to one or a small number of platforms if there is some degree of differentiation.

Therefore, digital platforms at the start tend to focus primarily on growing and maintaining their user base—i.e. winning the market—by providing free access and ease of use. Once the platforms reach a certain level of maturity with a substantial user base, the focus is then on monetising the large user base through licensing fees and advertising revenues.

Given the value at risk and the competitive pressure against English law, it is important that sufficient investment is made in maintaining and growing the user base for English law.

Second, due to the free-rider problem and for the obvious reason that nobody ‘owns’ English law, **coordinated efforts across industries, as well as the government, are required to achieve the biggest impacts in promoting the use of English law.**

Indeed, efforts have been made by industry bodies in the legal services sector—the Bar Council and the Law Society—to promote the use of English law on various international platforms.<sup>108</sup> There has been some success where various jurisdictions from different parts of the world started to adopt some areas of English law in developing their own laws.<sup>109</sup> Another example is the UK Jurisdiction Taskforce’s Legal statement on Cryptoassets and Smart Contracts on the status of cryptoassets, distributed ledger technology and smart contracts under English private law and the publication of digital dispute resolution rules that we discuss in section 4.4.

However, considering the importance of English law to the UK economy, and the risks and opportunities involved, it is not sufficient to rely solely on these

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regulation implied huge economies of scale in the manufacture of handsets and network hardware, so prices fell rapidly, and interoperability between networks and across countries was much easier to achieve. See World Economic Forum (2018), ‘[3 ways that regulation benefits economies](#)’, 18 July.

<sup>107</sup> This is called the ‘market-creating’ and ‘market-growing’ benefits from standard setting. Ibid.

<sup>108</sup> For example, see: <https://www.lawsociety.org.uk/en/topics/international/english-law-day-ukraine-2021>, or <https://www.barcouncil.org.uk/support-for-barristers/international/international-missions-and-events/english-law-week-mexico-speaking-opportunities.html> (each last accessed 21 May 2021).

<sup>109</sup> Stakeholders in the legal services sector have mentioned the role of English law in newly developed insolvency laws in jurisdictions such as Mexico and Saudi Arabia, as well as advising on the legal framework for the Dubai International Financial Centre (DIFC) and Astana International Financial Centre (AIFC) in Kazakhstan—see, for example, <https://aifc.kz/advisory-bodies-on-legal-matters/> (last accessed 10 August 2021).

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efforts. The free-rider/positive externality problem is a large hurdle to overcome, especially if a significant upfront investment is needed. Such investment is likely to deliver value for money through the value that comes with an increase in transactions under English law (as illustrated in section 4), as well as the associated increase in employment and tax revenue.

With English law serving as an important element of infrastructure and providing significant value for the UK economy as a whole, the optimal level of investment made by individual private parties alone is likely to be lower than the socially optimal level without further coordination. For instance, new legal technology may be useful to employ in order to address the free-rider problem while still growing and maintaining the user base of English law. However, there may not be sufficient incentive for a single party to fund, develop and maintain such a solution on its own.

Indeed, solving this market failure will require a significant level of coordination among various private parties and the public sector. In addition, multiple factors, such as favourable regulation and the high-skilled labour market, along with a strong legal system, need to be aligned to successfully position the UK as a leader in new sectors and markets.

While funding for these activities to promote and manage English law may come from the industry, support from the government could be in the form of a government mandate but delivered by the private sector, or other forms of support, such as public information campaigns, cultural expectations, and the assistance of a central coordinating body.

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## 6 Conclusion

English law is an underappreciated national asset that underpins various forms of economic activity in the UK. It is also part of what makes the UK an attractive place to do business for internationally mobile activity.

Like other pieces of infrastructure, English law directly contributes economic value (through the legal services sector). However, the wider benefit comes from a legal system's role in underpinning and encouraging business transactions throughout the economy (i.e. outside of the legal services ecosystem).

1. **Increased productivity of other key sectors in the UK.** The UK is a leading location for developments in legal and professional services globally. Agglomeration effects allow this expertise to permeate through the wider UK economy, increasing productivity across sectors.
2. **Reduction in transaction costs for UK firms trading internationally.** The prevalent use of English law internationally means that UK firms outside of the legal services sector will often be able to trade internationally using English law. This allows UK firms to trade internationally with lower transaction costs thanks to their familiarity with English law.

These effects operate in a virtuous cycle, delivering continual benefits to the UK. All of these effects increase the competitiveness of the UK.

However, the 'provision' of English law suffers from market failure due to the free-rider problem where the market does not provide sufficient incentives for private parties to support and promote English law to the extent that would maximise the overall benefits to the UK from the use of English law. Alternatively speaking, there is a positive externality deriving from the wider benefits for the UK beyond the legal services sector.

This is in the context of increasing competitive pressure from other governing laws and other jurisdictions for internationally mobile transactions. These transactions have a tendency to 'tip', which means that once the use of a governing law reaches a critical mass in a given market, most market participants tend to use that law because of the benefit from using standardised contract and procedures.

Therefore, investment to maintain and grow the user base of English law is particularly important given this global competitive pressure. It is, however, unlikely that individual private parties would achieve a sufficient level of investment alone without further coordination. Lack of investment in English law would then lead to economic inefficiency where significant benefits to the UK economy from the use of English law in internationally mobile transactions fail to materialise.

As a result, **greater coordination and support in promoting the use of English law in the international economy would be valuable and should be seen in the context of the wider economic benefits as we have outlined in this report.**

The English courts and independent judiciary play a vital role in developing the law, and are an integral part of the asset that is English law. As such, a key consideration in most effectively maximising the value from English law is the extent to which certain systems, resources and innovations surrounding an

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independent judiciary can be employed to the greatest effect to enable the judicial function to continue developing a pre-eminent system of law.

Our report also highlights several areas that require further discussion between the legal services ecosystem and the government.

1. Given the importance of English law to the UK economy, which has not been widely recognised and appreciated, **which organisations either in the private or public sector should coordinate efforts in nurturing and strengthening this asset for the benefit of the UK as a whole?** Can new technology be used more effectively to promote English law, and if so what role can the legal sector, other private parties and public bodies play in this?
  2. Many sectors with internationally mobile transactions demonstrate important network effects—i.e. ‘winner takes all’. While English law has been in a leading position due to the UK exhibiting strengths in areas such as maritime, insurance and capital markets, there are new areas of law arising, for example, in ESG, green finance, and cryptocurrencies. Given that the judiciary is a crucial asset in developing the law, and that speed is often of the essence to capture the user base, **who should take responsibility for ensuring that English law be promoted as an international business platform and that the UK is well placed to take advantage of these opportunities?**
  3. Lastly, **what would be the best form of investment in English law that can appropriately reflect the significant value that English law brings to the UK?**
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## A1 English law underpins significant value through internationally mobile transactions: four examples

To illustrate the size of the internationally mobile transactions that have relied substantially on English law as the governing law, we highlighted in section 4 four examples from a wide range of sectors in the UK economy. In this annex, we provide a more detailed explanation of each sector and how English law underpins a large proportion of internationally mobile transactions and economic value. The four sectors discussed are:

- the maritime sector (section A1.1);
- commodity trading (section A1.2);
- ISDA swaps and derivatives (section A1.3);
- insurance sector (section A1.4).

In these example sectors, English law plays a crucial role in the generation of economic value for the UK economy.

For each example, we give an overview of the sector and its importance to the UK economy. We then examine the prominence of English law within the relevant internationally mobile transactions before assessing some of the risks and opportunities in each market. In each case, most of the value generated for the UK economy comes from businesses outside the legal services sector through the mechanisms outlined in section 3.

### A1.1 Maritime sector

The maritime sector comprises various interlinked industries such as shipping, ports, and marine and maritime business services. It covers the transportation of freight and passengers, the physical building of vessels, and the operation of ports. It also includes a large industry of maritime business services, from shipbrokers to finance providers and insurers. Much of these activities are internationally mobile, though currently the UK is a leading global maritime hub, and English law is the leading choice for shipping and associated commercial contracts.

#### A1.1.1 Size of the market

**The UK maritime sector as a whole has been estimated to contribute between £14bn and £17bn of direct gross value added (GVA) annually to the UK economy.**<sup>110,111</sup>

The UK has a large industry supplying business services to the maritime sector, which contribute approximately £4bn to the UK economy.<sup>112</sup> Many of these businesses provide services to international clients, and thus most of their transactions can be considered to be internationally mobile transactions.

The UK has a market-leading 35% of global maritime insurance premia and 60% of protection and indemnity (P&I) clubs.<sup>113</sup> Maritime legal services are also an area of strength, with London leading in dispute resolution services.

<sup>110</sup> Eddings, G., Chamberlain, A., Colaco, H. and Philips, I. (2020), '[The Shipping Law Review: United Kingdom – England & Wales](#)', June.

<sup>111</sup> Maritime UK (2019), '[State of the maritime nation report 2019](#)', September.

<sup>112</sup> CEBR (2017), 'The economic contribution of the UK Maritime Business Services industry', September.

<sup>113</sup> See: <https://www.maritimeuk.org/about/our-sector/maritime-business-services/> (last accessed 5 May 2021).

London is a major centre for mediation, with a total value of cases mediated each year of around £11.5bn, including many shipping cases.<sup>114</sup> It is estimated that 80% of the world's maritime arbitrations are dealt with in London.<sup>115</sup> The UK is home to leading governance and regulatory bodies,<sup>116</sup> and is home to the Baltic Exchange, a leading source of market information on trading and settlement of both physical and financial shipping derivatives.

A stylised picture of this ecosystem is shown below in Figure A1.1. The diagram shows four broad categories of businesses involved in the maritime ecosystem:

- ship building—this comprises the shipyards where new vessels are built, as well as the suppliers of equipment and materials required;
- ship ownership, management and port services—this category includes ship owners (who may buy vessels via brokers) and ship managers who are commissioned to operate the ship. At ports, owners often rely on ship agents to liaise with various port authorities and port services;
- ship users—charterers hire a vessel from a shipowner. The charterer may own cargo itself, or use the vessel to deliver cargo on behalf of someone else;
- professional services—a wide variety of affiliate service providers are involved in the maritime sector. Ship brokers may act as intermediaries between ship builders, owners and charterers. Other important services include finance, engineering and insurance. Around 60% of the business services GVA in the maritime industry comes from insurance (see section A1.4 for a discussion of insurance).<sup>117</sup> Classification societies establish and maintain technical standards, and surveyors examine vessels to report on their condition. The maritime legal sector provides advice to all participants in the ecosystem and assists in dispute resolution.

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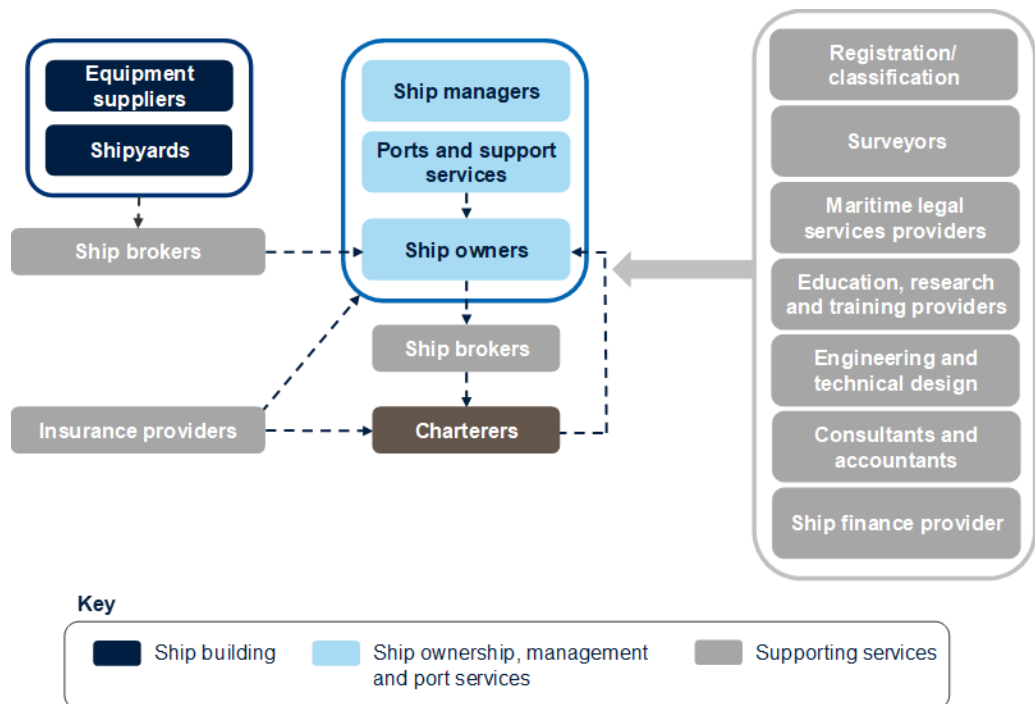
<sup>114</sup> Eddings, G., Chamberlain, A., Colaco, H. and Phillips, I. (2020), '[The Shipping Law Review: United Kingdom – England & Wales](#)', June.

<sup>115</sup> LLMA (2018), 'Call for Evidence Response Maritime 2050'.

<sup>116</sup> For example, the International Maritime Organization and the International Association of Classification Societies.

<sup>117</sup> PwC (2016), '[The UK's Global Maritime professional services: Contribution and trends](#)', research report published by the City of London Corporation.

Figure A1.1 Illustrative diagram of the maritime sector ecosystem



Source: Oxera.

The maritime sector particularly benefits from business ‘clustering’ due to the widespread use of sub-contracting, outsourcing and the use of highly specialised skills.<sup>118</sup> Businesses in a similar sector are able to gain productivity advantages by locating close to one another, thus benefitting from greater specialisation, knowledge spillovers and access to specialised labour. Maritime clusters evolve over time. One model describes how initially a cluster is focused on more basic services and would tend to be located around shipyards or ports.<sup>119</sup> As the cluster develops, it may become a centre for various maritime business services. Ultimately, the centre can become distinct from the physical activities that it serves, as agglomeration effects become critical for success.

The UK, and London in particular, has become the leading global hub of international maritime services. This is no longer directly dependent on the growth of the UK as an importer/exporter/owner/operator of vessels.

There are many reasons for the success of the UK as a global maritime centre that attracts a large proportion of internationally mobile transactions. A rich maritime heritage, access to a highly skilled workforce, strong education institutions and a stable business environment are all important factors. Another important attraction of the UK maritime cluster is the widespread use of English law.

<sup>118</sup> For a more detailed analysis of the competitiveness of the UK maritime sector and a discussion of ‘clusters’ in this industry, see Oxera (2015), ‘[International competitiveness of the UK maritime sector](#)’, May.

<sup>119</sup> Lam, J.S.L. and Zhang, W. (2011), ‘Analysis on Development Interplay between Port and Maritime Cluster’, December.

### A1.1.2 Overview of governing laws

**English law is the preferred legal framework for global commercial maritime contracts.** As a report published by the City of London Corporation notes:<sup>120</sup>

Use of English law and UK arbitration internationally for maritime business is a cornerstone of the UK's strength in maritime law.

Indeed, the widespread use of English law as the industry standard in maritime contracts across the globe has historically given the UK an advantage and 'unrivalled legal and judicial expertise'.<sup>121</sup>

According to the London Maritime Arbitrators Association, more maritime disputes are referred to arbitration in UK than in any other location, with London accounting for approximately 80% of maritime arbitrations.<sup>122,123</sup> Specialist courts, such as the Commercial and Admiralty Courts, hear the majority of shipping litigation and have a strong reputation internationally.<sup>124</sup>

Although other maritime hubs will also have some expertise in English law, the UK is at a major advantage thanks to the number of legal practitioners and the depth of existing expertise.

### A1.1.3 Risks and opportunities

While the UK remains the primary global hub for maritime services, and English law remains the most common legal framework for global maritime contracts, there is growing potential competition in this area. Singapore in particular has been promoting itself as a centre for arbitration of maritime disputes under contracts governed by English law.<sup>125</sup>

London currently remains the most popular choice of jurisdiction for maritime arbitration, with Singapore and Hong Kong the two strongest competitors (these currently lag far behind, though they likely have ambition to grow in this area).<sup>126</sup> The success of the UK as the leading global arbitration seat directly results in significant revenue for the UK. This is not only in the form of legal fees to UK law firms, but also from the use of specialist consultants and technical experts, who are mostly based in the UK.<sup>127,128</sup> However, as other regional hubs seek to expand in the coming years, the use of English law and the UK as the pre-eminent global hub may become increasingly at risk.

More generally, Singapore, Shanghai and Hong Kong have each recently pursued active strategies to attract maritime business services. Singapore is now the second largest maritime services hub after London.<sup>129</sup> It has also been estimated that as Asia grows as a market for global container trade flows, an

<sup>120</sup> PwC (2016), op. cit., p. 21.

<sup>121</sup> See: <https://www.maritimeuk.org/about/our-sector/maritime-business-services/> (last accessed 5 May 2021).

<sup>122</sup> See: <https://lmaa.london/about-lmaa/> (last accessed 5 May 2021).

<sup>123</sup> HFW (2019), 'The Maritime arbitration universe in numbers: One year on', May.

<sup>124</sup> In 2018 and 2019, 60% of cases heard in the Commercial Court involved litigants based outside England and Wales according, see: <https://thelawreviews.co.uk/title/the-shipping-law-review/united-kingdom-england-wales#footnote-000> (last accessed 5 May 2021).

<sup>125</sup> LLMA (2018), 'Call for Evidence Response Maritime 2050'.

<sup>126</sup> Although a newly established Nordic arbitration centre promoted by Scandinavian maritime clusters may also emerge as an alternative to the UK for international maritime arbitration. See HFW (2020), 'The Maritime arbitration universe in numbers: London remains ever dominant', May.

<sup>127</sup> LLMA (2018), 'Call for Evidence Response Maritime 2050'.

<sup>128</sup> Maritime London (2017), 'London arbitration, just a few good reasons why'.

<sup>129</sup> PwC (2016), op. cit.

increasing share of some business service transactions—such as marine cargo insurance—may be situated in Asia.<sup>130</sup>

### Box A1.1 Value at risk in the maritime sector—stylised scenarios

If competition were to cause UK maritime business to move elsewhere and possibly be governed by a law other than English law, this would represent a significant loss to the UK. We illustrate this using the following stylised scenarios.

- A 10% reduction in UK maritime business could mean a loss to the UK economy of approximately **£400m each year**.
- A reduction of 30% in UK maritime business could lead to **a loss of approximately £1.2bn to the UK each year**.

Due to the agglomeration effects described above, a reduction in size of this important part of the maritime cluster may have a much wider effect in the long run.

Nevertheless, there exist opportunities for the UK to promote the use of English law in maritime transactions as the sector continues to expand globally. Continued success of English law would enable the UK maritime cluster to further attract internationally mobile transactions. For instance, if the UK maritime business sector were to expand by 5%, this could represent an **additional £200m** for the UK economy.

Source: Oxera analysis, based on data from CEBR (2017), 'The economic contribution of the UK Maritime Business Services industry', September.

## A1.2 Commodity trading

Commodities are undifferentiated goods that are often used as inputs in the production of other goods and services. Examples of commodities include agricultural products, metals, and crude and refined oil.

The sale and purchase of commodities is regularly carried out on commodities exchanges—a market in which multiple buyers and sellers trade commodities using commodity-linked financial products that are governed by standard form contracts.<sup>131</sup> This allows producers and consumers of commodities from all around the world to trade in centralised marketplaces with standardised terms using standard form contracts offered by exchanges and trade associations.<sup>132</sup>

The trading of commodities therefore involves internationally mobile transactions as commodities can be traded on exchanges worldwide.

### A1.2.1 Size of the market

The global commodities market is very difficult to value in its entirety due to its vast size and the variety of commodities traded. However, it is possible to look at the UK's position in global commodities trading through examining the position of UK commodities exchanges and trade associations.<sup>133</sup>

The UK is home to the London Metal Exchange (LME), the world centre for non-ferrous metals trading.<sup>134</sup> **Trading on LME platforms totalled \$11.6tn in 2020.**<sup>135</sup>

<sup>130</sup> See, for example, BCG (2014), '[London matters: The competitive position of the London Insurance Market](#)', p. 16.

<sup>131</sup> United Nations (2009), '[Overview of the world's commodity exchanges – 2007](#)'.

<sup>132</sup> Ibid.

<sup>133</sup> A commodity trade association is a membership organisation that facilitates and promotes international trading of commodities and offers support to members in the form of contracts, arbitration, trade assurance, training and networking.

<sup>134</sup> London Metal Exchange (2020), '[Guide to the London Metal Exchange](#)'.

<sup>135</sup> Ibid.

The UK is also the location of a number of the world's trade associations that issue standard form contracts that parties can adopt for on-exchange commodity trading.<sup>136</sup> This includes the Grain and Feed Trade Association (GAFTA), the Federation of Oils, Seeds and Fats Association (FOSFA), and the Refined Sugar Association (RSA). The standard form contracts offered by these trade associations are commonly used for on-exchange commodity trading. **85% of the global trade in oils and fats is traded under FOSFA contracts,<sup>137</sup> and 80% of the global trade in grain is traded under GAFTA contracts.<sup>138</sup>**

The UK's position in global commodities trading generates significant value for the UK. Figure A1.2 provides a stylised illustration of the commodities trading ecosystem with the physical delivery of traded commodities.

Pre-trade, producers and processors are involved in the production of commodities. Raw and processed commodities for trade are then deposited in storage facilities approved and licensed by commodity exchanges. This involves a number of supporting activities, including transportation services and insurance services. Quality certifiers determine the quality and quantity of the commodity deposited in the storage facility and report this to the commodity exchange.

Producers and buyers trade commodities on the commodity exchange, where the commodity exchange provides a centralised marketplace for trading under standardised terms. Trade is facilitated by brokers, who bring buyers and sellers together, and commodity trade associations, which offer standard form contracts for on-exchange commodity trading. Trading is also supported by services such as legal services. Finally, clearing houses provide clearing and settlement services for trades.

Post-trade, the physical settlement of goods entails delivering the agreed upon quantity of the commodity to the buyer at the agreed date. This requires transport services, such as shipping, supported by a number of activities including insurance, ship brokers and port services. In the event of a dispute between contracting parties, arbitration services may be used.

As producers and buyers from anywhere in the world can trade commodities on exchange, not all of the activities illustrated in Figure A1.2 below will be based in the UK. However, where trading occurs on an exchange located in the UK and the transaction is governed by English law, this will generate value for the UK economy through the following channels.

- The financial, legal, and clearing activities associated with the trading of commodities on exchange and the activities of GAFTA, FOSFA and RSA generates value for the UK.
- GAFTA, FOSFA, RSA and the LME offer arbitration services in the event of disputes between transacting parties.<sup>139</sup> Therefore, when arbitration is needed, UK legal services are likely to be used, generating value for the UK economy.

<sup>136</sup> It should be noted that commodity exchanges, such as the LME, also offer standard-form contracts for commodity trading.

<sup>137</sup> FOSFA International (N.D.), '[FOSFA International: About us](#)'.

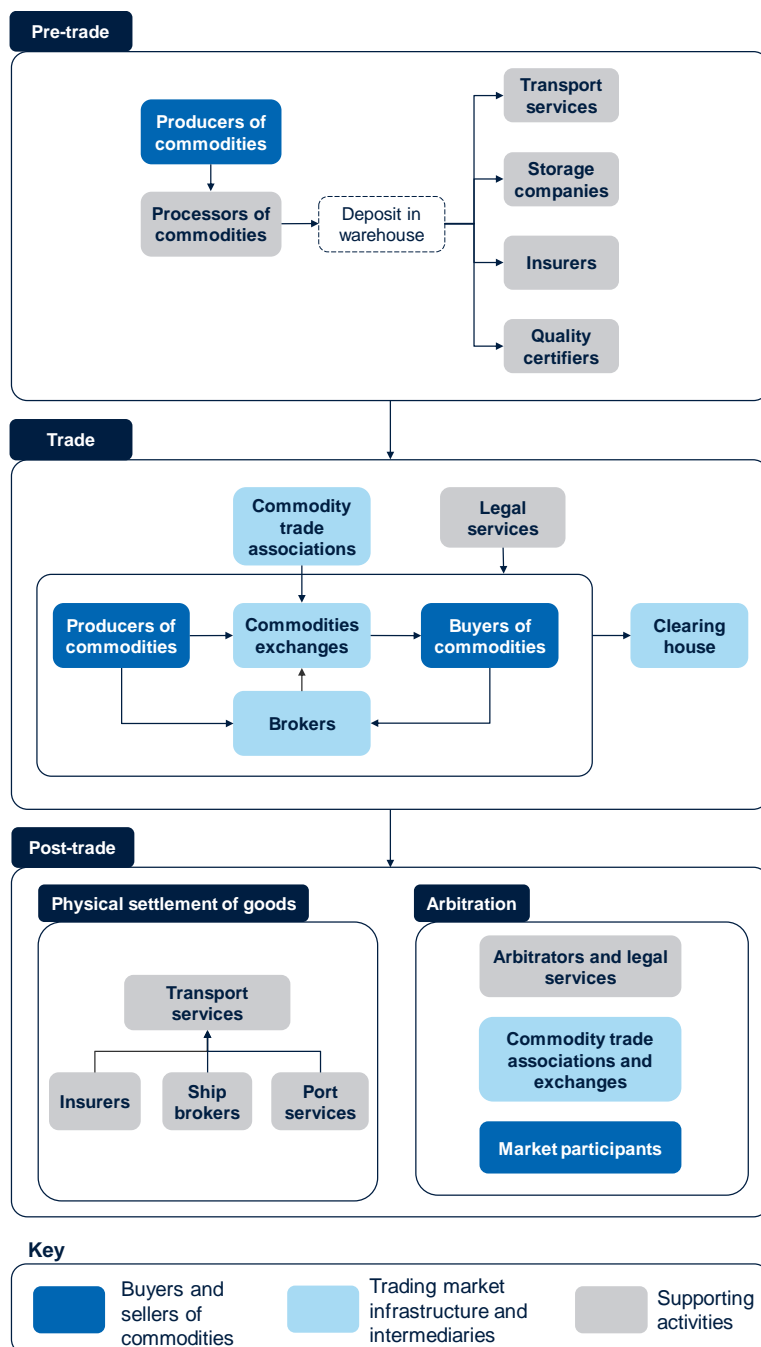
<sup>138</sup> GAFTA (N.D.), '[Membership](#)'.

<sup>139</sup> GAFTA (N.D.), '[Arbitration](#)'; RSA (2021), '[Rules and Regulations](#)', 2 March; LME (N.D.), '[Arbitration](#)'; FOSFA (N.D.), '[Arbitration](#)'.

- As discussed in section A1.2, the use of English law to govern commodity transactions promotes English law as a global standard for these internationally mobile transactions.
- As outlined in section A1.1, the UK is a global hub of international maritime services. Therefore, the global trading of commodities generates additional value for the UK through the UK maritime sector.

Where the other activities illustrated in Figure A1.2 below do occur in the UK, further value will be generated for the UK.

**Figure A1.2 Illustrative diagram of the commodities trading ecosystem**



Note: This diagram is based on the assumption that the trade involves the physical delivery of commodities at the agreed upon date.

Source: Oxera.



### A1.2.2 Overview of governing laws

The standard form contracts offered by GAFTA, FOSFA, RSA, and the LME are governed by and decided in accordance with English law.<sup>140</sup> Therefore, **English law is likely to have governed at least \$11.6tn of global metals transactions,<sup>141</sup> approximately \$92.4bn of global oils and fats transactions,<sup>142</sup> and \$98.2bn of global grains transactions in 2020.**<sup>143</sup>

Similarly, the rules and procedures for the arbitration services offered by GAFTA, FOSFA, RSA, and the LME are drawn up under the framework of English law.<sup>144</sup>

Where commodities are traded on exchanges elsewhere in the world, it may be the case that these transactions are governed by law other than English law. For example, contracts and arbitration services offered by the Shanghai Futures Exchange in China are written in accordance with the law, regulations and judicial interpretations of the People's Republic of China.<sup>145</sup>

### A1.2.3 Risks and opportunities

The standard form contracts offered by GAFTA, FOSFA and RSA can be used for on-exchange commodity trading anywhere in the world. Given the current prevalence of GAFTA and FOSFA contracts in commodities trading globally, there is likely minimal risk to the use of these contracts globally. Therefore, English law is likely to continue to govern the majority of these transactions.

However, for UK-based commodity exchanges such as the LME, global competitive risks,<sup>146</sup> and trade tensions such as Brexit may pose a risk to trading volumes and the use of English law in these transactions.<sup>147</sup> Below, we discuss two reasons for this in the context of the LME and Brexit.

- Prior to the end of the Brexit transition period, LME contracts were classified as exchange traded derivatives in the EU. However, as of 1 January 2021, the LME is no longer deemed to be an equivalent trading venue under EU law. As a result, any contract executed on the LME from 1 January 2021 onwards is considered to be over the counter (OTC) from an EU perspective. This has the potential to introduce additional regulatory obligations for EEA counterparties and UK counterparties trading with EEA counterparties,<sup>148</sup> increasing transaction costs. This could reduce the volume of trading on the LME or hinder the expansion of trading on the LME

<sup>140</sup> GAFTA (N.D.), '[All Contracts](#)'; LME (2021), '[London Metal Exchange Rules and Regulations](#)', 18 March; RSA (2021), '[Rules and Regulations](#)', 2 March; FOSFA (N.D.), '[Contracts](#)'.

<sup>141</sup> London Metal Exchange (2020), '[Guide to the London Metal Exchange](#)'.

<sup>142</sup> 85% of the global trade in oils and fats is traded under FOSFA contracts. Total global trade in oils and fats was \$108.7bn in 2020. See FOSFA International (N.D.), '[FOSFA International: About us](#)'. See United Nations (N.D.), '[UN Comtrade Database](#)'.

<sup>143</sup> 80% of the global trade in grain is traded under GAFTA contracts. Total trade in cereals was \$122.8bn in 2020. See GAFTA (N.D.), '[Membership](#)'; United Nations (N.D.), '[UN Comtrade Database](#)'.

<sup>144</sup> GAFTA (N.D.), '[Arbitration](#)'; RSA (2021), '[Rules and Regulations](#)', 2 March; LME (N.D.), '[Arbitration](#)'; FOSFA (N.D.), '[Arbitration](#)'.

<sup>145</sup> Shanghai Futures Exchange (N.D.), '[General Exchange Rules of the Shanghai Futures Exchange](#)'.

<sup>146</sup> Competition from other metals exchanges worldwide could include COMEX, located in the USA, and the Shanghai Futures Exchange, located in China. Where commodities are traded on exchanges elsewhere, transactions are likely to be governed by a law other than English law.

<sup>147</sup> Where commodities are traded on exchanges elsewhere, transactions are likely to be governed by a law other than English law. For example, contracts and arbitration services offered by the Shanghai Futures Exchange in China are written in accordance with the law, regulations and judicial interpretations of the People's Republic of China. See Shanghai Futures Exchange (N.D.), '[General Exchange Rules of the Shanghai Futures Exchange](#)'.

<sup>148</sup> LME (2021), '[LME Brexit Factsheet](#)', January.

in metals in which it is a non-dominant platform globally.<sup>149</sup> This may reduce the use of English law for the trading of metals globally, as market participants may choose to trade on exchanges other than the LME, using contracts governed by a law other than English. This may also lead to a reduction in the use of UK arbitration services.

- UK-incorporated members of the LME, such as brokers, may establish an EEA presence in order to service EEA clients because, as of 1 January 2021, UK-incorporated brokers can no longer advertise services in the EU.<sup>150</sup> Members of the LME outside of the UK can still trade on the LME,<sup>151</sup> and there may or may not be a change in the volumes traded on LME platforms and the use of English law as a result. However, this represents a clear movement of activity associated with commodities trading out of the UK as a result of Brexit.

### Box A1.2 Value at risk in commodity trading—stylised scenarios

The LME states that it is confident that London will continue to be an appropriate location for the trading of ferrous and non-ferrous metals.<sup>1</sup> However, given issues relating to Brexit and competitive pressures from commodities exchanges globally,<sup>2</sup> the position of the LME in commodities trading, and hence the use of English law to govern these transactions could be affected.

- If 10% of transactions on the LME moved elsewhere, annual trading value governed by English law could fall by **\$1.2tn**.
- A more severe loss of 30% could entail an annual reduction in trading value governed by English law of **\$3.5tn**.

A reduction in the use of English law to govern these transactions would reduce the value generated for the UK through the mechanisms discussed in section 3. The movement of these transactions would then reduce the additional value generated through the UK commodities trading ecosystem as associated activities are shifted to other global centres.

If trading moves to exchanges elsewhere in the world, it may be the case that these transactions are governed by a law other than English law. This will reduce the building of precedent under English law and may reduce the use of English legal services in, for example, arbitration. If English law is less likely to be chosen to govern commodity trading contracts, it may be more difficult to attract lost trading activity back to the UK.

On the other hand, if non-ferrous metals trading on the LME grew by 4% in line with estimates for the increase in steel demand,<sup>3</sup> this could represent an **additional \$464bn** in annual trading value governed by English law.

Note: <sup>1</sup> The LME has received a licence or an exemption in EEA jurisdictions where members will require access to its trading systems: LME (2021), '[LME Brexit Factsheet](#)', January. <sup>2</sup> Other metal exchanges include: COMEX, located in the USA, offering futures and options products for trading metals such as gold, silver, copper, and aluminium; exchanges operated by the Deutsche Börse Group located in Germany, which offers contracts for energy, environmental products, freight, metal and agricultural commodities; and the Shanghai Futures Exchange, located in China, offering ferrous and non-ferrous metals contracts. <sup>3</sup> Estimates suggest that global steel demand is estimated to grow by 4.1% in 2021. See World Steel Association (2020), '[worldsteel Short Range Outlook October 2020](#)', 15 October.

Source: Oxera analysis, based on data from London Metal Exchange (2020), '[Guide to the London Metal Exchange](#)'.

<sup>149</sup> The LME is the dominant trading platform for non-ferrous metals—however, it has a non-dominant but growing market presence in ferrous metals. London Metal Exchange (2020), '[Guide to the London Metal Exchange](#)'.

<sup>150</sup> LME (2021), '[LME Brexit Factsheet](#)', January.

<sup>151</sup> The LME has received a licence or an exemption in EEA jurisdictions where members will require access to its trading systems: LME (2021), '[LME Brexit Factsheet](#)', January.

### A1.3 ISDA swaps and derivatives

A derivative is a contract between two or more parties, the value of which is based on an underlying financial asset, index, or security.<sup>152</sup> Derivatives are used as financial instruments to help companies hedge various risks—for example, fluctuations in interest rates and foreign currency exchange—that their businesses are exposed to. Derivatives can be traded on securities exchanges that offer standardised contracts, or can be traded OTC, involving privately negotiated contracts between parties.

As OTC derivatives contracts are privately negotiated and are not required to be standardised,<sup>153</sup> the International Swaps and Derivatives Association (ISDA) developed the ISDA Master Agreement—an umbrella agreement setting out standard contract terms between parties trading OTC derivatives. The ISDA Master Agreement provides parties with certain legal and credit protections, and is commonly used for OTC derivatives transactions internationally.<sup>154</sup>

#### A1.3.1 Size of the market

The OTC derivatives market is very difficult to value in its entirety due to its vast size. However, OTC interest rate derivatives are the most commonly traded type of derivative globally.<sup>155</sup> **Global daily average turnover of OTC interest rate derivatives was \$7340bn in 2019, in which the UK accounted for 50% of this activity.**<sup>156</sup>

Looking at European derivatives trading, the size of the European OTC derivatives market in 2019 was €627tn. **82% of all European derivative trading involved a UK-domiciled counterparty in 2019.**<sup>157</sup>

The UK's substantial market share in global and European derivatives trading generates significant value for the UK through the UK derivatives market ecosystem. Figure A1.3 provides a stylised illustration of the UK derivatives market ecosystem.

Market participants such as banks, investment firms and credit institutions buy and sell derivatives, either for their own accounts, or on behalf of end-users including corporations, governments and organisations that provide investment services such as pension schemes.

Intermediaries and clearing houses facilitate the trading of derivatives. Intermediaries are those in the business of dealing, making a market, or intermediating derivatives transactions.<sup>158</sup> This includes brokers, who bring buyers and sellers together, and market makers—firms that are ready to buy and sell derivatives on a regular and continuous basis at a publicly quoted price.<sup>159</sup> Clearing houses provide clearing and settlement services for trades, and can act as a central counterparty, where the clearing house sits between

<sup>152</sup> Examples of underlying assets, indices and securities include commodities, interest rates, stocks, foreign currency. Bank for International Settlements (2016), '[Glossary](#)', October.

<sup>153</sup> Thomson Reuters Practical Law (N.D.), '[Over-the-counter \(OTC\) Derivative](#)'.

<sup>154</sup> Thomson Reuters Practical Law (N.D.), '[ISDA Master Agreement](#)'.

<sup>155</sup> Bank for International Settlements (2019), '[Triennial Central Bank Survey of Foreign Exchange and Over-the-counter \(OTC\) Derivatives Markets in 2019](#)'.

<sup>156</sup> Ibid.

<sup>157</sup> European Securities and Markets Authority (2020), '[EU Derivatives Markets ESMA annual Statistics Report 2020](#)'.

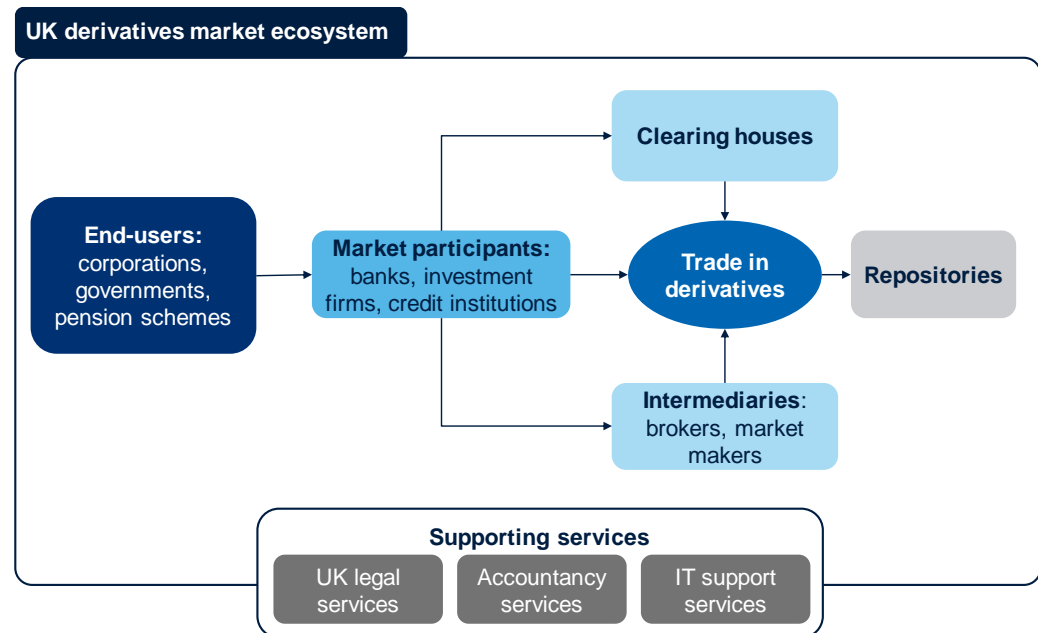
<sup>158</sup> International Organisation of Securities Commissions (2012), '[International Standards for Derivatives market intermediary regulation](#)', June.

<sup>159</sup> Ibid.

market participants as the counterparty to buyers and sellers.<sup>160</sup> For example, the UK is home to the London Clearing House (LCH) and ICE Clear Europe. Finally, repositories collect and maintain records of derivatives transactions.<sup>161</sup>

OTC derivatives transactions and the UK derivatives market ecosystem is supported by services such as legal services and accountancy services.<sup>162</sup> Legal services may be needed during pre-trade due diligence, particularly for complex derivatives transactions, or may be required upon disputes between counterparties.<sup>163</sup>

**Figure A1.3 Illustrative diagram of the UK derivatives market ecosystem**



Source: Oxera.

### A1.3.2 Overview of governing laws

The ISDA Master Agreement contains the parties' choice for the governing law of the contract and transactions under its terms and includes a provision specifying the jurisdiction that can adjudicate upon disputes between parties.<sup>164</sup>

Prior to 2018, ISDA offered English, New York and Japanese law-governed Master Agreements.<sup>165</sup> According to ISDA,<sup>166</sup> 'virtually all' ISDA Master Agreements entered into between counterparties based within the EU or the EEA were governed by English law in 2018. **Therefore, English law likely governed at least €661.5tn of global derivatives transactions in 2018.**<sup>167</sup>

<sup>160</sup> Bank for International Settlements (2016), '[Glossary](#)', October. It should be noted that in OTC bilateral clearing, market participants trade directly with one another and the clearing house does not act as the central counterparty.

<sup>161</sup> Ibid.

<sup>162</sup> ISDA (N.D.), '[About ISDA](#)'.

<sup>163</sup> The ISDA Master Agreement includes a provision specifying which courts can adjudicate upon any disputes about swaps governed by the Master Agreement.

<sup>164</sup> ISDA (2018), '[2018 ISDA Arbitration Guide and Choice of Court Jurisdiction Guide](#)', 17 December.

<sup>165</sup> ISDA (2018), '[Brexit and the ISDA Master Agreement](#)', 8 January.

<sup>166</sup> ISDA (2018), '[ISDA Publishes French and Irish Law Master Agreements](#)', 3 July.

<sup>167</sup> According to ISDA,<sup>167</sup> 'virtually all' ISDA Master Agreements entered into between counterparties based within the EU or the EEA were governed by English law in 2018. Data for 2018 EU OTC derivatives transactions from European Securities and Markets Authority (2019), '[EU Derivatives Markets ESMA Annual Statistics Report 2019](#)', 9 December.

However, in July 2018, ISDA published Irish and French law-governed Master Agreements, in order to provide parties with the option to continue trading under a EU member-state law with EU jurisdiction clauses once the UK left the EU.<sup>168</sup> This allows for the retention of specific benefits of EU legislation, for example, insolvency law,<sup>169</sup> and allows EU/EEA counterparties to retain automatic recognition and enforcement of judgements when trading with each other.<sup>170</sup>

### A1.3.3 Risks and opportunities

While it is not yet clear if there has been a reduction in the use of the English law-governed Master Agreement, global trade tensions, such as Brexit, pose a risk to the UK's position in global derivatives markets and the use of English law to govern derivatives contracts.

Data suggests that this risk has already begun to materialise in the OTC euro denominated interest rate swap market.<sup>171</sup>

#### Box A1.3 Value at risk in ISDA swaps and derivatives

As mentioned above, interest rate derivatives are the most commonly traded type of derivatives globally. The daily average turnover of OTC euro interest rate swaps was approximately \$917bn in 2019.<sup>1</sup>

- The UK had a 40% market share of the euro interest rate swap market in July 2020, while the market share of both the EU and the USA was 10%.<sup>2</sup>
- After the UK–EU Trade and Cooperation Agreement was signed on 30 December 2020, the UK's market share in euro interest rate swaps fell to just 10% in January 2021, while the EU's market share increased to 25% and the USA's market share to 20%.<sup>3</sup>

**This implies that average UK daily turnover of OTC euro interest rate swaps fell from \$367bn in July 2020 to \$92bn in January 2021.**

The movement of these transactions away from the UK decreases the value generated to the UK economy through the UK derivatives market ecosystem, where financial, legal, professional and clearing activities are shifted to other European and global financial centres. For example, the LCH and ICE Clear Europe could see clearing and settlement activity move elsewhere in Europe or globally. This also has an implication for the cost of hedging interest rate risk for UK businesses, since they may not have access to the global pool of liquidity or it is now more costly to access that liquidity pool. A reduction in the use of English law to govern these transactions will further reduce the value generated for the UK through the mechanisms discussed in section 3.

Despite the risks, there may be opportunities for English law in existing markets and as new financial products are developed and come to market. For example, if 50% of lost euro denominated interest rate swaps transactions were to relocate back to the UK, this would represent a \$137.5bn increase in average daily turnover.

Opportunities for English law in new and emerging markets, such as in sustainable finance, are discussed in section 4.4.

Note: <sup>1</sup> Bank for International Settlements (2019), '[Triennial Central Bank Survey of Foreign Exchange and Over-the-counter \(OTC\) Derivatives Markets in 2019](#)'. <sup>2</sup> IHS Markit (2021), '[2021: Brexit, no equivalence for pan European OTC Interest Rate Swaps markets, what the data shows so far...](#)', 10 February. This market share data is for all OTC single currency (euro in this case) swaps. <sup>3</sup> Ibid. It is not clear from the data which jurisdictions within the EU the transactions are now located in. Hence, it cannot be said if there is a risk of these transactions 'tipping' to one

<sup>168</sup> ISDA (2018), '[ISDA Publishes French and Irish Law Master Agreements](#)', 3 July.

<sup>169</sup> Some EU national insolvency laws require contracts to be subject to EU/EEA law in order to qualify for safe harbour protections following a bankruptcy: ISDA (2018), '[ISDA Publishes French and Irish Law Master Agreements](#)', 3 July.

<sup>170</sup> Ibid.

<sup>171</sup> IHS Markit (2021), '[2021: Brexit, no equivalence for pan European OTC Interest Rate Swaps markets, what the data shows so far...](#)', 10 February. This market share data is for all OTC single currency (euro in this case) interest rate swaps, which may be expected to be severely affected by Brexit. Thus, this data is not representative of changes in alternatively denominated interest rate swaps or other derivative products.



or a small number of jurisdictions, and thus a risk of competitive agglomeration in one or a small number of financial centres.

Source: Oxera analysis, based on IHS Markit (2021), '[2021: Brexit, no equivalence for pan European OTC Interest Rate Swaps markets, what the data shows so far...](#)', 10 February, and Bank for International Settlements (2019), '[Triennial Central Bank Survey of Foreign Exchange and Over-the-counter \(OTC\) Derivatives Markets in 2019](#)'.

## A1.4 International insurance contracts

Insurance provides protection against events that are inherently uncertain at an individual level. Insurance involves a transfer of risk from an individual or business to third parties, who pool various risk exposures together. Insurance is made available by a large number of providers who offer insurance against a vast array of different types of risk exposure. These range from retail customers insuring their cars or homes, to complex areas such as cyber risk or space risk for commercial clients.<sup>172</sup> Such risk is underwritten through insurance contracts. Much of this business, along with many associated supporting services, is internationally mobile in nature.

### A1.4.1 Size of the market

The insurance sector as a whole accounts for approximately £30bn in GVA.<sup>173</sup> It accounts for 1.1% of total UK employment, and its net exports are over £15bn per year.<sup>174</sup>

The UK insurance industry comprises life insurance, general retail insurance, and commercial insurance. We focus in particular on those parts of the insurance sector where contracts are especially internationally mobile. In particular, we consider the 'London Market' as a cluster of insurance providers and support services that provide for specialty insurance and reinsurance for international corporate clients.

**The London Market is the leading global insurance/reinsurance hub, accounting for approximately £80bn in gross written premium in 2018.**<sup>175</sup> It employs around 47,000 people and contributes 7.7% of London's GDP, as well as the majority of the insurance sector's exports.<sup>176</sup> Indeed, the London Market is a particularly global one, with international risks accounting for 80% of premium underwritten.<sup>177</sup>

**The London Market accounted for £15bn in direct GDP contribution in 2018, rising to £26bn when including indirect contributions.**<sup>178</sup> A stylised diagram of the insurance value chain for internationally traded insurance/reinsurance business is shown in Figure A1.4 below. We identify five broad categories within the overall value chain:

- **policyholders**—these are largely commercial firms (including firms from around the world) that seek to insure themselves against a certain risk, and to a lesser degree these also include individuals;
- **intermediaries**—the policyholder typically accesses insurance through a broker. This 'local' broker in turn may contact a 'London Market' broker;

<sup>172</sup> See Lloyd's of London (2021), '[What we insure](#)'.

<sup>173</sup> ABI (2019), '[The state of the market 2019](#)', p. 6.

<sup>174</sup> House of Commons exiting the European Union committee (2017), '[Insurance and pensions sector report](#)'.

<sup>175</sup> London Market Group (2020), '[London matters 2020](#)', p. 9.

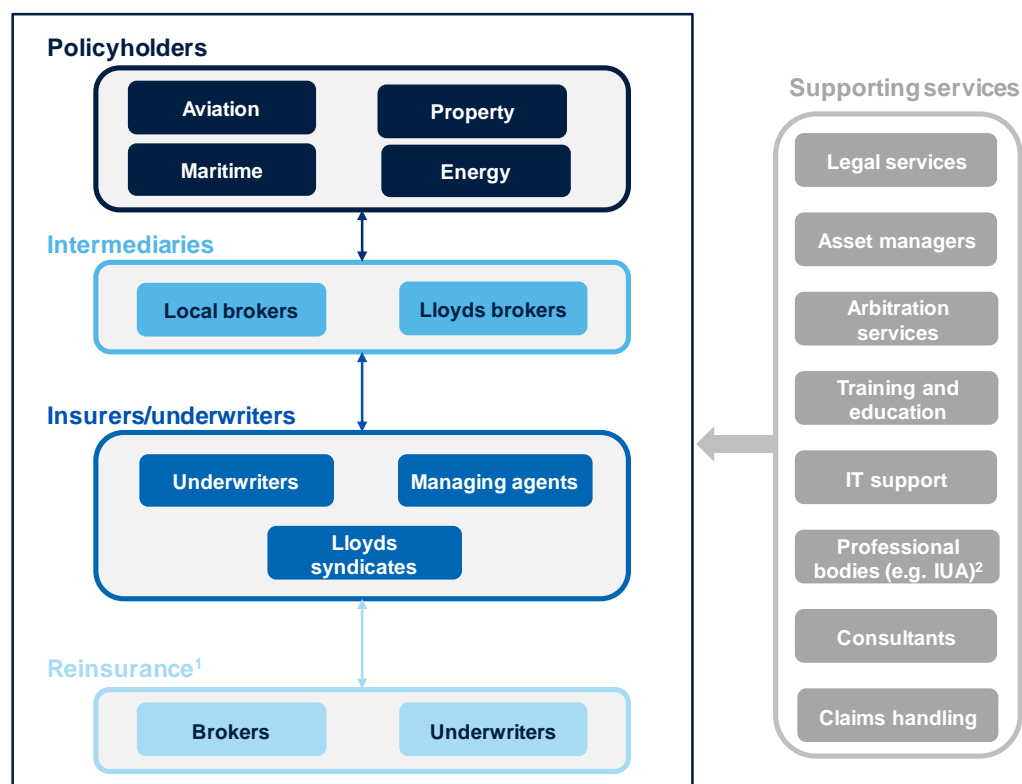
<sup>176</sup> London Market Group (2020), '[London matters 2020](#)'.

<sup>177</sup> EY (2019), '[2020 UK Insurance outlook](#)'.

<sup>178</sup> London Market Group (2020), op. cit.

- **insurers/underwriters**—these underwrite the risk and are backed by capital that secures the claim of the insured. At Lloyd’s of London, syndicates are groups made up of members who provide capital. A syndicate will have a managing agent who appoints the underwriter to insure/reinsure the risk on behalf of the syndicate;<sup>179</sup>
- **reinsurance**—in some cases, insurers transfer some of the risk to another insurer. On the whole this is done through a reinsurance broker, though it can also be done directly;<sup>180</sup>
- **supporting services**—there is a wide range of additional supporting services, including claims handling, lawyers, asset managers and actuarial consultants.

**Figure A1.4 Illustrative diagram of the international insurance contracts ecosystem**



Notes: <sup>1</sup> Reinsurance in this diagram also includes ‘retrocession’, where reinsurers themselves reinsure risks they receive with other reinsurers. <sup>2</sup> IUA, International Underwriting Association.

Source: Oxera.

As with the maritime sector, the insurance/reinsurance industry benefits from agglomeration effects as participants throughout the value chain exchange information and develop expertise. Proximity of location also facilitates efficient interaction with the numerous vital supporting services.

<sup>179</sup> For further explanation of the role of the syndicate (and other participants) at Lloyd’s of London, see ‘[The Lloyd’s market](#)’.

<sup>180</sup> Reinsurers themselves also reinsure the risks they receive with other reinsurers (referred to as ‘retroceding the risk’). London is a very significant retrocession market in itself, though for simplicity in this report we include retrocession under the broader category of reinsurance.



### A1.4.2 Overview of governing laws

The widespread use of English law in internationally traded insurance/reinsurance contracts is one important factor behind the economic value that the insurance/reinsurance market brings to the UK. **English law is chosen to govern many insurance and reinsurance contracts globally.**<sup>181</sup>

English courts have deep knowledge and expertise in international insurance matters.<sup>182</sup> Indeed, English courts are well versed in the complex issues that can arise with insurance/reinsurance contracts and have built a well-established body of case law to address such issues. Arbitration is also a common method of resolving disputes in insurance/reinsurance contracts and such contracts usually provide for arbitration with the seat in London.<sup>183</sup>

### A1.4.3 Risks and opportunities

After London, the next largest insurance/reinsurance hubs globally are Bermuda, Zürich and Singapore. Although London remains the largest market, recent years have seen faster growth for the Bermuda and Singapore markets.<sup>184</sup>

Highlighting the international mobility of this business, the London Company Market reports that restructuring necessitated by Brexit has meant that £4.5bn premium income was lost to operations in the EU in 2019.<sup>185</sup> While this is not a direct consequence of a change in governing law, it does highlight the potential for such transactions to move jurisdictions.

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<sup>181</sup> The Law Society (2010), 'England and Wales: The jurisdiction of choice – Dispute resolution'.

<sup>182</sup> For our engagement with stakeholders, we understand that a large number of standard London Market wordings have existed and evolved over time, such that participants know what they mean and what risks are or are not covered. This has helped to ensure that contract certainty (under English law) has been a key value in the London Market—one important attraction of London as a hub for internationally traded insurance contracts.

<sup>183</sup> Thomson Reuters Practical Law (2020), '[Insurance and reinsurance in the UK: overview](#)'.

<sup>184</sup> London Market Group (2020), op. cit.

<sup>185</sup> The London Company Market covers that part of the London Market that is not in the Lloyd's of London marketplace: IUA (2020), 'London Company Market, Statistics report', October, p. 20.

### Box A1.4 Value at risk in international insurance contracts—stylised scenarios

As trade in some primary markets shifts to new regions (e.g. growing global container flows in Asia), demand for insurance will follow since a large share will remain insured locally (e.g. Asia may become the largest market for marine cargo insurance).<sup>1</sup> In turn, this may lead to an increase in the use of international insurance contracts not under English law.

- If 10% of international insurance activity currently in the London Market were to move elsewhere and possibly be governed by a law other than English law, this could represent a **£8bn in gross written premium** and an **impact on GDP of approximately £2.5bn per year**.
- A 30% reduction in UK international insurance activity from the London Market would involve losing **£24bn in gross written premium**, and **£7.5bn loss to the UK economy**.

However, there are many new developments and innovations within the insurance sector that provide opportunities for continued growth of business in the UK market and under English law. Potential new developments may include cyber risks, privacy concerns around the use of biodata, and climate change, as well as ever-evolving technologies.<sup>2</sup> There is therefore great potential for the future use of English law in internationally mobile insurance transactions to generate significant value for the UK economy. For instance, if there were to be a 5% increase in activity in this market, this could represent a benefit of over **£1bn** to the UK economy per year.

Note: <sup>1</sup> See, for example, BCG (2014), '[London matters: The competitive position of the London Insurance Market](#)', p. 16. <sup>2</sup> For example, see IUA (2020), '[Annual review 2019/20: Navigating the changing nature of risk](#)'. Also see Oxera (2020), '[The value of cyber insurance to the UK economy](#)', October.

Source: Oxera analysis, based on House of Commons Exiting the European Union Committee (2017), '[Insurance and pensions sector report](#)', and London Market Group (2020), '[London matters 2020](#)'.

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