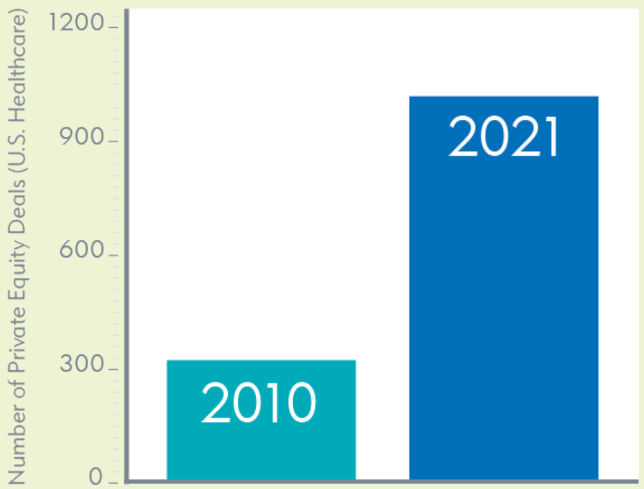
Strategies for Success: A Guide to Insurance Considerations for Healthcare-Focused Private Equity Firms

Private equity (PE) investment has become a powerful force in the healthcare industry over the past decade, driving both innovation and significant operational changes within the sector.

PE funds invested about $750 billion in U.S. healthcare companies between 2013 and 2023. While recent macroeconomic factors have contributed to investment stagnation, experts still predict that PE-healthcare partnerships are here to stay.

As this investment trend has gained momentum, it would be logical to assume that PE-backed healthcare and insurer partnerships have also gained momentum, but this is not necessarily the case. Many insurers are wary of partnering with PE-backed healthcare companies, in part due to ongoing debates about how PE investment impacts care decisions and patient safety.

Private Equity Deals in U.S. Healthcare Over Time



In 2010, there were 325 Private Equity (PE) deals in the United States healthcare sector. In 2021, there were 1,013 deals – a 312% increase.

Private equity supporters cite improved operational and technical efficiencies that allow doctors to dedicate more time and mental capacity to treating patients, while critics point to concerns such as cost-cutting measures, potential declines in patient care quality and heightened regulatory scrutiny. PE investment success is also highly variable based on factors such as the type of facility, what medical specialties it serves and its financial and operational needs. Nevertheless, private equity investment in healthcare is not inherently positive or problematic; rather, it requires a thoughtful and nuanced evaluation of its risks and opportunities.

Overall, the sector presents a unique challenge to investors and insurers alike because companies must balance their priority to deliver quality patient care with their financial priorities. They must also achieve this while remaining compliant with complex regulatory standards.

For their part, underwriters and brokers can successfully tackle this complex blend of risks through thoughtful evaluation and an emphasis on collaboration. By evaluating the PE firm's experience and operational structures such as Managed Service Organizations and financial history, underwriters can better understand key factors and complete a more holistic risk assessment. In understanding this assessment, brokers can be better positioned to deliver value to their clients and adapt to the evolving market by partnering with experienced carriers, asking the right questions and fostering intentional communication with clients and underwriters.

Assessing Risk in Private Equity-Backed Healthcare

For underwriters, evaluating PE-backed healthcare risks can involve assessing several key considerations that provide insight into potential exposures. The following factors can help insurers better understand the stability and future performance of the investment:

1 Private Equity Experience with the Healthcare Business

A significant risk indicator for a healthcare business backed by private equity is whether the PE firm has prior experience managing other healthcare companies in their portfolio. PE firms with a strong track record in healthcare are more likely to understand complexities such as regulatory requirements and clinical quality standards. These firms often have established best practices for managing healthcare entities, including systems to handle operational risk, patient care standards and compliance.

When a PE firm has previously invested in healthcare, insurers are also better able to evaluate their business strategy specifically as it pertains to the sector. Carriers can examine factors such as how they approach partnerships with facility operators and facility performance. Hence, a crucial part of the underwriting process is assessing the PE firm's portfolio history and healthcare-specific expertise to make informed decisions about the risk profile of the entity.

2 The Presence and Role of a Managed Service Organization (MSO)

Another important consideration is whether the entity operates through a Managed Service Organization (MSO). The presence of an MSO often signals a well-structured and compliant business model, reducing risk from an underwriting perspective.

According to America's Physician Groups, "MSOs are business organizations that provide the necessary administrative infrastructure, scale and technology for risk bearing organizations to function successfully in their relationships with contracted payers and regulators." In these types of partnerships, the PE fund often owns the MSO. MSOs are particularly important in private equity-backed healthcare transactions because they allow PE firms to manage operational efficiencies while leaving clinical decision-making to licensed professionals.

Partnerships that include MSOs can help physicians to maintain their ability to make autonomous patient care decisions free from administrative burdens and external pressure to turn a profit.

MSOs can also help mitigate risks associated with regulatory violations. Many states have strict rules governing the corporate practice of medicine, which prohibit corporate entities from practicing medicine or employing a physician to provide professional medical services. Almost every state has exceptions for employment of physicians by certain health care entities, making the MSO model even more critical in these locations.

As of 2024, more than a dozen states, along with federal regulators, have either enacted or have pending legislation that would govern private equity healthcare transactions. This includes mandates for MSO involvement in any transaction to manage operations for the facility and for healthcare professionals to take over the day-to-day concerns of patient care.

MSOs additionally function to protect PE firms from liabilities related to their portfolio companies. For instance, a judge in Texas recently dismissed an antitrust lawsuit* filed by the Federal Trade Commission (FTC) against a leading PE firm. The suit accused the firm of suppressing competition and driving up the price of anesthesiology services in the state, deciding that the firm, a minority equity owner, did not in fact control the actions of its portfolio company, an anesthesiology provider.

By using an MSO structure, private equity firms can remain compliant with these laws while still managing the business aspects of the healthcare practice.

*The court held that FTC did not prove that a leading PE firm's minority equity stake and minority representation on the board of the portfolio company caused them to be "in control" of the portfolio company, providing the FTC the opportunity for a future case against a controlling investor.

3 Understanding the PE Firm's Financial and Legal History

A private equity firm's financial history also provides insight into evaluating the risk of insuring a healthcare entity under its ownership. Underwriters will often look to financial statements, legal histories and operational performance to understand a PE firm and its healthcare entities on a deeper level.

Financial instability, such as past bankruptcies or a history of litigation, may raise concerns, but a skilled underwriter will assess the broader context of these events, their impact on the firm's operations and their relevance to the current risk profile.

Bankruptcy History: This can typically be viewed negatively but can sometimes indicate a firm's ability to recover from financial distress and restructure effectively. Underwriters seek to determine and understand the type of bankruptcy filed—whether a reorganization under Chapter 11, a liquidation under Chapter 7, or another form—and evaluate the reasons behind it. Underwriters also consider the outcomes of bankruptcy. For example, were creditors paid, and were obligations to other stakeholders met? Understanding these details helps carriers differentiate between firms that demonstrate resilience and adaptability versus those that may pose ongoing financial risks.

Litigation History: Analyzing this is another important component of financial assessment. Underwriters may investigate the nature of the lawsuits, the motions filed and the outcomes. Not all lawsuits are equally impactful. A dismissed lawsuit or one resolved without significant penalties may have minimal effect on the firm's risk profile. However, lawsuits involving allegations of fraud, negligence or major regulatory violations may indicate deeper systemic issues. The underwriter's role is to sift through these details to determine whether the litigation history reflects isolated incidents or a pattern of problematic behavior.

This comprehensive approach allows underwriters to evaluate the private equity firm not just on past incidents but on its capacity for operational and financial improvement.

By focusing on these considerations, underwriters take a thoughtful risk management approach to distinguish between high- and low-risk healthcare entities backed by private equity.

Strategies for Broker Success

Understanding the nuances of private equity investments and fostering effective communication with both clients and underwriters is essential for brokers to successfully navigate this evolving landscape. Taking the following steps can help brokers to thrive in this environment:

1 Partner with Experienced Insurance Carriers.

Given the complexities of private equity-backed healthcare risks, brokers should seek out carriers with experience in this niche. An experienced carrier will likely have dedicated teams specializing in both healthcare and private equity risks, providing deeper expertise and a more tailored approach. Carriers with both specializations will often have more resources such as proprietary data tools at their disposal. Additionally, working with a carrier capable of underwriting multiple lines of business and offering a single point of contact for claims can streamline the process for brokers and clients alike.

2 Evaluate Controls and Protections in Place.

During the due diligence stage, it may benefit brokers to spend additional time assessing the mechanisms that exist between the private equity firm and the portfolio company to ensure the business operates under best practices. This includes examining the governance structures, operational safeguards and compliance measures established by the private equity firm. This information can help underwriters to better evaluate the risk and ensure that they are providing the client with appropriate coverage.

3 Familiarize Clients with Carrier Point of View.

Brokers are encouraged to ensure that their clients are familiar with the information that underwriters will request during a transaction. This includes understanding the financial goals, operational changes, long-term strategy and regulatory compliance. Underwriters will use information to evaluate the risk fully, and brokers who anticipate these needs can streamline the process. When provided with complete, well-rounded information from the beginning of a transaction, underwriters are also more likely to be able to offer better policy terms to clients. By understanding the carrier's needs and how this information can benefit their clients, brokers can help to facilitate a faster, more desirable deal.

4 Maintain Regular Communication with Underwriters.

Brokers are encouraged to establish a regular communication cadence with their underwriters to discuss updates to their PE clients' portfolio company pipeline. Regular communication ensures that underwriters, brokers and clients remain aligned, reducing the likelihood of last-minute issues and fostering a smoother working relationship.

As private equity continues to shape the healthcare sector, brokers have a pivotal role in ensuring risks are understood, managed and insured effectively. By selecting an experienced insurance partner, performing specialized due diligence, introducing clients to the underwriting process and fostering collaboration with underwriters, brokers can navigate this dynamic landscape with confidence. The more informed and proactive brokers are, the better positioned they will be to deliver value to their clients and adapt to the evolving market.

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