McGuireWoods

THE CORNER SERIES

Episode 92: Winning the Insurance Game in Healthcare Transactions, With Hannah Ellithorpe

Episode Summary

"Underwriters are more willing to take creative approaches now than they would have been in the last couple of years," observes Hannah Ellithorpe, executive director and head of healthcare and life sciences at Atlantic Global Risk. The former M&A attorney shares with McGuireWoods partner and host Geoff Cockrell how the representation and warranty insurance market has evolved toward more flexible coverage terms at lower costs.

Hannah details how softening market conditions have created opportunities to secure previously unattainable regulatory compliance coverage and discusses emerging products specifically designed for healthcare providers serving vulnerable populations.

Transcript

Voice over (00:00):

This is The Corner Series, a McGuireWoods series exploring business and legal issues prevalent in today's private equity industry. Tune in with McGuireWoods partner Geoff Cockrell, as he and specialists share real-world insight to help enhance your knowledge.

Geoff Cockrell (00:19):

Thank you for joining another episode of the Corner Series. I'm your host, Geoff Cockrell, a partner at McGuireWoods. Here at The Corner Series, we try to bring together dealmakers and thought leaders at the intersection of healthcare and private equity to talk about deal trends and other dynamics. Today, I'm thrilled to be joined by my friend, Hannah Ellithorpe. Hannah is the Executive Director and Head of Healthcare and Life Sciences with Atlantic Global Risk. Hannah, if you could introduce yourself and a little bit more about what Atlantic does.

Hannah Ellithorpe (00:48):

Yeah, sure. So, thank you, I'm excited to be joining you today. I am an M&A attorney by trade, so I haven't always been in transactional risk. I started my career at Ropes and Gray. I was in the Boston office initially, and then spent a little bit of time in the New York office as well. I split my time pretty evenly between doing private equity and healthcare transactions and then also life sciences transactions, more in the public company space. Just by virtue of being in the Boston office, I had a lot of exposure to our biotech and pharma clients and device clients, that kind of thing.

(01:20):

So after spending some time in private practice, I fortuitously landed at Atlantic, it was a call from a recruiter. And explored with an initial interview, was one of, I was tied for employee number three. That was back in 2018. They kind of wooed me into the company in this big beautiful boardroom and wined and dined me, and then I went to process my I-9 in a broom closet sized office and I was absolutely terrified. But it's been a fun journey, so I really have helped build the business. We have over 100 professionals now, which is really exciting and offices all over the U.S. and in Canada, and we're also looking to have one in Latin America as well. Yeah, so I helped build the business and once we had kind of a critical mass of deals, I started to focus again on healthcare and life sciences because that's my background and that's what I love to do.

(02:11):

I did take a brief hiatus from Atlantic, so I haven't been here straight from 2018. I was an underwriter spearheading healthcare underwriting efforts at a carrier called Mosaic, and so I did that in 2021, did that for about a year, and then came back to Atlantic. And now the only kind of difference between what I did before and what I'm doing now is that we've formalized this healthcare and life sciences focus, really just by virtue of seeing a need across the market from our clients and just an increase in increase from healthcare and life sciences clients in the RWI space.

Geoff Cockrell (02:42):

Hannah RWI is so kind of pervasive in the M&A space, certainly in healthcare and life sciences. And it now spans most of the size of market M&A, whether kind of platforms or many add-on acquisitions. But from where you sit, what are some of the interesting trends that are changing in RWI, especially in healthcare and life science?

Hannah Ellithorpe (03:04):

Yes, it's definitely been an interesting last five years, but the last couple of years have been really interesting, kind of in the market difference that we've seen in racing and kind of coverage trends from that huge boom that we had post-COVID, where everybody was just maxed out. The RWI market was similarly maxed out. That's when I was underwriting, we would get anywhere upwards of 50 to 80 submissions a day. We had six underwriters quoting or five underwriters quoting, and we were only allowed to quote two, so we were just declining deals left and right. There wasn't enough capacity in the market, and as a result, people were really, really choosy. Coverage terms were extremely restrictive. Prices were through the roof and it was really tough to get deals done, especially at the end of the year, that kind of thing.

(03:49):

Obviously, there's been a major slowdown in M&A over the course of the last couple of years, and that's tough for everyone, but there have been some kind of interesting, and maybe I could say positive trends and unique things that have come out of that, specifically in healthcare as well.

(04:05):

So I mean, just generally, it's still kind of a great time to buy insurance for deals because the prices are still pretty low. We're starting to creep into the low threes for ROLs, 3% for healthcare deals in some trickier spaces like hospice, home health, those types of things. But we're still seeing across the board for more attractive risks, I'll say like mid twos to high twos. And that, I mean, we were up at almost 4% a few years ago, so that's a pretty crazy decrease in the number of underwriters, including Euclid, who kind of leads the market, are saying that rates are unsustainably low and that they need to increase. So it'll be interesting to see kind of how that starts to evolve over the course of the next several months with what I view as an uptick in M&A activity. I would agree, I think there's probably a course correction that needs to take place, but I don't know that we'll ever get back to where we were. That was unsustainably high, in my opinion.

(05:04):

Similarly, retentions have gone down as well. They used to be retention on any given kind of run-of-the-mill bread and butter deal on RWI was always 1% dropping to 0.5% at 12 months from closing, and now you can get anything, I mean, even on a tough healthcare deal. I think I'm doing a deal right now in the hospice space where we have 65 basis points dropping 40 basis points, which is really low. So, terms are still attractive, numbers wise.

(05:31):

In terms of neat things that have occurred in the healthcare space as a result of this slowdown in M&A activity, it's given us the opportunity to push the market in creative ways and get people to take coverage positions that they wouldn't have otherwise taken. It still takes a level of underlying industry expertise and that kind of thing, but we've gotten... I mean, the market has really moved to now covering regulatory compliance reps for six years on any given deal. Again, doing that deal, same deal in the hospice space. We were able to argue for regulatory compliance coverage for six years for no additional premium.

(06:10):

Things like that, just really pushing underwriters to take positions that they wouldn't otherwise have taken, and streamlined approaches to diligence, creative things that bidders, they're trying to differentiate their bids. So they're trying to take creative approaches to key diligence work streams like billing and coding. We're helping them put together these streamlined diligence work streams, ensuring that they're still covering the things that the carriers care about, but also that it's going to take less time to dig up documentation, lower costs, that kind of thing. Underwriters are more willing to take a look at these things now than they would've been in the last couple of years, which is great.

Geoff Cockrell (06:47):

For sure, and some of the evolution for ISED touches on what you're describing of underwriters being willing to work with you on kind of what the coverage is actually going to look like. There was a time where any sort of anomaly that had risk connected to it was going to be treated as an exclusion, meaning you were pulling it straight out of a policy coverage, which sends you back to a difficult discussion with the seller. But that kind of approach has evolved to where not every risk is treated as a violation. How have you seen that evolution, because that's been transformative as well, of having insurance actually deal with the problems that you're trying to navigate in the deal?

Hannah Ellithorpe (07:25):

Yeah, actually encountered this on a recent transaction where there were two kind of pending audits. One of them was a ordinary course, kind of routine type of audit. Right? The other one, not necessarily routine, but very common in that particular industry sector. Both of the audits while still open and pending, they had actually very kind of positive results over the course of the audit, and the risk associated with any kind of material practical liability in terms of the outcome was very, very low with each one of these audits. I would say if this were four or five years ago, you'd have a broad exclusion in the policy from the carrier. They would push very, very hard to have this exclusion, and it would include things like indirect results and other investigations, lawsuits, those types of things. Just unknown factors kind of in and around these audits, right? Even though they were really not that scary.

(08:22):

Now it's kind of like, all right, let's look at this intelligently on a case by case basis. In this particular scenario, this particular target has a really good track record. Their documentation practices are above average in the industry sector that they're in. They have great regulatory compliance. These audits have thus far kind of resolved, not fully resolved, but have gone favorably for them. Let's take a creative approach here and have some really narrowly tailored exclusions surrounding the facts and circumstances of the audits themselves, but no exclusions otherwise. Right?

Geoff Cockrell (08:54):

Right, exactly. And the other place where that's kind of touched on in the context of the deal is there may be an issue where, as between the buyer and the seller, there's still going to be a contractual allocation of that risk to the seller. And that shows up as often like a straight standalone indemnity, meaning anything comes from this issue, it's going to be the seller's problem, not the buyer's problem. And there was a time where there was a lot of consternation about that approach, that the moment you start down that pathway from an underwriting perspective, it was viewed as a concessional liability and it was going to be matched with an exclusion, when that was not really what you were doing with the standalone indemnity. You were just saying, "Hey, we can see that there's potential risk in this and as between us, it's yours." That's been an evolution that's been a welcome turn, but it makes the discussions more involved.

Hannah Ellithorpe (09:43):

Yeah, I think that's an important thing that we have always done as part of our process that Atlantic, is ensuring that we take a close look at the agreement and when we see anything, any kind of specific indemnity proposed at the outset of a transaction, we get context on that specific indemnity before we go out to the market, because we don't want to set hairs on edge and have underwriters wondering why there's a specific indemnity in proposing an initial exclusion that's not necessary. But like you said, that doesn't happen as often as it used to, which is great.

(10:12):

I would say one other kind of development that has been positive but also has had some impacts that just require us to be a bit more careful is that with the kind of softening and slowdown of the market, we've had an uptick just in underwriters generally willing to underwrite two healthcare and life sciences deals, which is good, right? Because we have more competitive tension, we have more to choose from. Nobody wants to pigeonhole to one or two underwriters on any given deal, and so it's been positive. The problem is, a lot of these folks don't have the requisite experience, and so they end up providing really clean, kind of non-binding indications for targets that they don't fully understand the complexities of.

(11:02):

For example, something like value-based care where they don't understand the risk that capitation arrangements carry, and they're not proposing any sort of coverage restrictions for that. At the outset, the client thinks that's great, and then what happens when you get into underwriting and they figure it out and they just compose a broad exclusion for financial statements, right? So there's a level of educating that has had to be done with respect to certain kind of healthcare underwriting groups at certain carriers. But I would say overall that's kind of improved over the course of the last few months as well.

Geoff Cockrell (11:35):

How would you describe pricing? Obviously, that's got supply demand impact, but also a claims history impact. What has been your experience with insurance claims, both in the frequency of them, the areas where they show up, and then will come back eventually to what the payment experience has been?

Hannah Ellithorpe (11:56):

Yeah, so frequency of claims, I would say has been kind of steady over the course of the last couple of years. They have increased somewhat for sure, in terms of the areas in which we see claims. Interestingly enough, specifically to healthcare, there have been kind of the big regulatory compliance claims in the healthcare space that have kind of knocked carriers out of healthcare altogether. But I would say on the whole, your run-of-the-mill, most common claims that you see even in the healthcare space still tend to be where we see them in other spaces, which is financial statements, labor and employment, and tax. Those are by far the most common areas. And healthcare in particular, we've seen an uptick in claims in the labor and employment space.

Geoff Cockrell (12:50):

One of the questions that I often get from clients that are considering RWI in a deal is that they understand that they may have less kind of credit exposure, meaning if you go to a carrier, you're not at risk that the seller is unable to pay the claim, but they have some anxiety about the actual collection experience with payers. What have you seen on that front? I would think, and my experience has been that there's a background kind of insurance industry kind of bent towards deny and delay, but RWI is very competitive and that kind of reputation, it would be very, very bad for an underwriter. What have you found the payout experience of folks has been?

Hannah Ellithorpe (13:31):

Yeah, you're correct. So, that is if an underwriter had developed the reputation of not paying claims in the RWI space, it would be catastrophic to their reputation. That's how they make money, that's how they get more deals. And it would word... I mean, it's such a niche insular industry, people would hear about it immediately and just stop using them. So, I would say they do want to pay out claims initially, at least.

(13:59):

In terms of the process, I think the biggest complaint that we get is that it's long, it takes too long, because like you said, the denial and the delay. And I would say the most important thing there is to have just a claims team that's going to be extremely proactive. We have a claims team at Atlantic that has actually taken on claims from other brokers and taken on claims elsewhere in the market. They move very, very quickly, and even on the most complex claims, they tend to close things out within a year. So, I would say it's just important to have a proactive team working with the legal team, because the lawyers have enough on their plates and it's just going to end up taking away too much time otherwise.

Geoff Cockrell (14:49):

Absolutely. With of similar dynamics on our side of the table, in the sense that not every law firm has this exactly, but we have a very developed practice that works on claims against insurers, and that's a very nuanced and specialized practice. And I wouldn't dream of approaching one of those situations without that kind of expertise. So yeah, you definitely need to know what you're doing when you dip into that water.

Hannah Ellithorpe (15:13):

Yeah, for sure. It's definitely important and important to kind of have that background knowledge of navigating the ins and outs of getting an insurer to kind of acknowledge breach, before you have a calculation of loss because as you know, a lot of these scenarios where you have indirect damages and you need forensic accountants and the calculation of loss can take a very, very long time to quantify. So, ensuring that the insurer is going to acknowledge that there's a breach at the outset and that you can get some progress and some momentum is really important.

Geoff Cockrell (15:44):

From where you sit, you guys see a pretty broad swatch of the market. Here we are, kind of partway into 2025. You mentioned the heady days in mid to late 2021 where deals were coming at all of us from every direction, which was both nice and terrible at the same time. This is not that time, but what does the market look like from where you sit? Is it looking better than it was a year ago? Is it looking kind of the same? What's it look like?

Hannah Ellithorpe (16:14):

Yeah, it's definitely looking better. We have had, it's funny, I feel like in the last several months I've never heard such a disparity among clients when I meet with them and kind of ask them how things are going. Some are like, "We're so busy, things are crazy," and then others are like, "It's extremely quiet still. We're not really sure what's going on." It's just, there has been such a disparity across folks that I've spoken to kind of in a similar space, which is interesting.

(16:39):

In terms of what I'm seeing, we had a slower January for sure. Mid-February, things started to pick up. We've definitely had a market increase in inquiries, initial inquiries. I would say one of the things that continues to happen is deals are dying more, I would say. Processes are getting to the very, very end and then dying more often than I would say I have seen in the last six years doing RWI. I don't know what that means. I don't know if it means that buyers are just being choosier in terms of moving forward with an investment, that they find something that they're just not comfortable with and they're just making those decisions less lightly than they were before. I'm not sure, but that is an interesting thing that I think is continuing to happen.

(17:25):

But I will say that with the political climate, everything is very uncertain. I think people thought the economy was going to boost a bit more at the beginning of the year than it did. I think uncertainty has kind of won the day, and we're definitely still seeing that. But I would say overall, things are starting to get busier and I feel positive about the outlook in 2025. I don't know if you feel similarly.

Geoff Cockrell (17:49):

Yeah, I feel more buyers wanting to reengage in the process, and some new buyers especially in healthcare, has been kind of an interesting evolution with some of the strategics becoming buyers in provider services arenas that weren't really buyers before. Whether that's device companies acquiring practices from a distribution chain perspective, or just other dynamics that are new.

(18:13):

I will say that the bias towards high quality continues to be high, and that it's much harder to get a deal to completion if it's got some bumps on it, and both from the perspective of the buyers themselves and also from the perspective of financing sources. And sometimes those bumps appear at the outset, sometimes they appear later, whether that is in diligence or as you pick up another quarter's worth of performance. Hiccups along that line can be harder to overcome than they were in easier markets. So I would, again, like you described, it's a bit mixed, more buyer interest, better triangulation on bid ask on pricing, but still a high preference for high quality, which is its own constraint on how active the market's going to be.

Hannah Ellithorpe (19:00):

Yeah, that makes sense. Totally agree.

Geoff Cockrell (19:02):

So Hannah, as we're making our way into 2025, the RWI market continues to evolve. Are there any new products coming online that we should be looking for?

Hannah Ellithorpe (19:11):

Yeah, so in the healthcare space, there are a couple that we've been working on in particular at Atlantic. There is one that's highly specific to physician practices with kind of vulnerable populations called Safeguard. That is an insurance policy that is specifically designed to cover sexual abuse and molestation, something nobody obviously wants to talk about, but it can be relevant on certain deals like in home health, in hospice, any kind of elder care, behavioral health with teens, people with disabilities, those types of things. And then I've seen it come up on transactions where there's been a broad exclusion for those matters because of something that had happened in the past. This particular insurance policy can kind of come in when there is a known issue and supplement coverage. And the cool thing about it is that it's actually kind of like a proactive policy, in terms of the fact that they will come in and help kind of establish policies and procedures and put things in place to prevent those types of things from happening in the future. So, kind of positive on that side, so that's one of them.

Geoff Cockrell (20:18):

I think one of the biggest values of insurance is not just underwriting the unknown risks, but helping people parse through a known risk. And especially in the context where even when it's presented, there's probably a low probability of a high magnitude outcome. Those can be very, very difficult to deal with between buyer and seller, but an insurance carrier is built to navigate those kinds of risks. So, continuing to develop products that are helping you deal with known issues is always a welcome addition.

Hannah Ellithorpe (20:51):

Yeah, our structured solutions team has grown exponentially over the course of the last several, actually even in the last several months. I mean, there's just been exponential growth and they've done some really incredible things and just they're in the life sciences space with respect to kind of intellectual property risks. And in the healthcare space, we've had a few recent inquiries with respect to regulatory compliance matters, litigation matters. These risks, they have to be developed enough, we have to be far enough along on the timeline in order for an underwriter to have something to sink their teeth into. Right? It needs to be a legal question rather than a factual question, and there needs to be something to analyze and underwrite to. But yeah, it's been really interesting to see the kind of things that they've done over the course of the last several months.

(21:43):

And then off that topic, in terms of the life sciences space and intellectual property and that kind of thing, we've been working actively to try and put together a bespoke product for license and collaboration agreements, licensing agreements in that space with respect to kind of non-commercialized intellectual property. And we get mixed reviews when we talk about it with clients, some think it's amazing idea, and then others think there's not really a market for it.

Geoff Cockrell (22:08):

Probably a function of how much risk they see in the underlying topic.

Hannah Ellithorpe (22:12):

Exactly, exactly, yeah. And the other thing is that I think the tough part is that these losses tend to be, it's not going to ensure whether or not the intellectual property works, right? And then the losses tend to be just so massive. So, it just depends on whether or not they're kind of thinking about the type of risk that we could potentially secure insurance for, and whether or not they feel that that's worth it in the context. Or if it's just the magnitude is just so much bigger and they just don't feel that it's necessary or worth it. But we've been working on it, it's been really interesting because the non-commercialized intellectual property space or non-commercialized chemical compounds, drugs, those types of things, that's been traditionally a bit more difficult to get those types of deals covered in the RWI space. There are carriers now that are more willing to do it, but because it tends to be more of a pure intellectual property risk, so it's been interesting to kind of make headway there and work with some carriers on some creative things.

Geoff Cockrell (23:09):

Ever evolving. Hannah, we could talk for quite a bit, but I think we'll end it there. It's always fun to work with your group, and I will say that kind of having your background and experience in the context of a deal really enables you to be ahead of a lot of these issues so they don't just drop on my desk. So, it's always great to have you on a deal.

Hannah Ellithorpe (23:27):

Great to hear. Yeah, really glad to have been a part of this today, and thank you so much.

Voice over (23:34):

Thank you for joining us on this installment of The Corner Series. To learn more about today's discussion, please email host, Geoff Cockrell at gcockrell@mcguirewoods.com. We look forward to hearing from you.

(23:47):