Advising the Congress on Medicare issues

Congressional request on private equity and Medicare

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MEDPAC

Introduction

- In 2019, the chairman of the Committee on Ways and Means asked the Commission to examine the role that private equity (PE) plays in Medicare
- The request does not ask the Commission to make any recommendations
- We plan to respond to the request with an informational chapter in our June 2021 report to the Congress

The request asks the Commission to examine four issues, to the extent feasible

- Gaps in Medicare data on provider ownership that make it difficult to track PE investments
- Business models that PE firms use when they invest in the health care sector
- Effects of PE ownership on Medicare costs, beneficiaries, and providers
- Extent of PE involvement in companies that participate in the Medicare Advantage (MA) program

What do we mean by “private equity”?

- PE is any activity where investors buy an ownership stake in a company or other asset that is not publicly traded
- The term can be used for a variety of investments, such as venture capital funds, growth capital funds, buyout funds, and hedge funds
- The growing prominence of PE in health care is largely due to buyout funds, so we plan to focus on them

Factors contributing to the rise of PE

- Public equity is much larger than private equity
  - Total capitalization of public markets: ~$37 trillion
  - Total investments across all types of private equity: ~$3 trillion
- However, the importance of PE has grown quickly, with buyouts the leading type of investment
  - Corporate tax system favors the use of debt
  - Interest rates have been low for an extended period
  - Pension funds have had to recognize unfunded liabilities and seek higher returns to reduce them

Note: Figures are preliminary and subject to change.

PE firms raise money from outside investors and create investment funds

- Primary investors in PE funds are institutions such as pension funds, endowments, and foundations
- Each fund operates for a specific time period (~10 years)
  - PE firm usually controls the fund's investment decisions
  - Outside investors cannot withdraw their money before the end of the fund's lifespan
- Most PE firms manage multiple investment funds

PE investment funds then acquire a variety of "portfolio companies"

- PE funds typically make most of their acquisitions during their first 3 to 5 years of operation
- Borrowed money often finances more than half of the cost of these acquisitions, and the company being acquired is usually responsible for repaying the debt
- PE funds have full control of their portfolio companies and try to improve their financial performance
- PE ownership usually lasts for 3 to 7 years

PE investment funds later try to sell their portfolio companies for a profit

- PE firms usually sell their portfolio companies during the second half of a fund’s lifespan
- Most companies are sold to strategic acquirers or other PE funds, or are taken public through an initial public offering
- Most PE firms are paid using a “2 and 20” model:
  - Annual management fee equal to 2 percent of total amount investors have committed to the fund
  - Performance fee equal to 20 percent of the fund’s profits

Assessing the returns on PE investments

- Some research has found that PE funds performed better than public equity before 2006
- Greater agreement that PE returns have been similar to public equity returns during the last decade
- Relative decline in PE returns reflects growing investment in the sector and higher prices for portfolio companies
- Performance of individual PE funds varies widely

PE involvement in health care has been growing

- PE investments in health care have become more noticeable over the past two decades
  - In 2019, PE funds spent $47 billion on buyout deals involving health care providers
  - Major sectors of interest included retail health, post-acute care, and physician practices
- PE interest has been driven by factors such as the aging population, predictable cash flow, and fragmented provider markets

Note: Figure is preliminary and subject to change.

Proposed workplan: Gaps in Medicare data on provider ownership

- CMS collects ownership information in the Provider Enrollment, Chain and Ownership System (PECOS)
  - PECOS has mainly been used for purposes such as provider payment and fraud prevention rather than analysis
  - GAO found it difficult to use PECOS data to identify PE-owned nursing homes
- We plan to interview CMS officials, state officials, and outside experts to see if there are ways to improve the accuracy and usability of PECOS data

Proposed workplan: PE business models when investing in health care

- Given breadth of PE investment in health care, business models likely vary across providers
- We plan to focus on PE investments in three sectors: hospitals, nursing homes, and physician practices
- We plan to interview stakeholders to better understand how PE firms increase the value of their companies
  - Increasing revenues versus lowering costs
  - Relative importance of Medicare versus other payers

Proposed workplan: Effects of PE ownership on costs, beneficiaries, and providers

- Conducting some type of quantitative analysis would be very challenging for several reasons:
  - PECOS data can be inaccurate and hard to use
  - Several commercial datasets on PE transactions are available, but none are considered comprehensive
  - Medicare administrative data has significant limitations
- Given these challenges, we plan to focus on reviewing the research literature and summarizing the challenges of using Medicare data

Proposed workplan: PE involvement in the MA program

- Our initial review suggests that very few plan sponsors are owned by PE firms
- Humana has in recent years launched joint ventures with PE firms to acquire home health agencies, hospices, and primary care centers
- We plan to interview representatives of PE firms and MA plans to better understand the extent and nature of PE involvement in this sector

Commissioner discussion

- Feedback on our proposed workplan
- Suggestions for helpful data sources or relevant studies on PE and health care