Attachment 6

Executive Summary of Administrative Services Agreement Fees

Executive Summary

Administrative Services Agreement Fees

Catholic Health Initiatives, ("**CHI**") engaged HealthCare Appraisers, Inc. ("**HAI**") to determine the fair market value of the services to be provided by CollabHealth Plan Services, Inc. ("**CHPS**") on behalf of Soundpath. HAI concluded that the fees set forth in the Administrative Services Agreement ("**Agreement**") are consistent with fair market value and meet the requirements of SSAP Nos. 25 and 70. Below is a summary of HAI's analysis.

HAI defined "fair market value" as:

> [T]he price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms' length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.[1]

Within a healthcare setting, fair market value is also defined as:

> [T]he value in arm's-length transactions, consistent with the general market value. "General market value" means the price that an asset would bring, as the result of *bona fide* bargaining between well-informed buyers and sellers who are not otherwise in a position to generate business for the other party; or the compensation that would be included in a service agreement, as the result of *bona fide* bargaining between well-informed parties to the agreement who are not otherwise in a position to generate business for the other party, on the date of acquisition of the asset or at the time of the service agreement.[2]

After consideration of the facts and circumstances specific to the Agreement, HAI determined that the most reasonable approaches to assessing the fair market value of the fee in the Agreement are the Cost and Market Approaches. HAI relied primarily on the Cost Approach, stating that its opinion is based on an analysis of the underlying costs expected to be incurred by CHPS in the administration of Medicare Advantage policies. The Cost Approach is defined by the *International Glossary* as "a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset." Furthermore, HAI stated that the Cost Approach is based upon the Principle of Substitution (*i.e.,* the premise that a prudent individual will pay no more for a property that he/she would pay to acquire a substitute property with the same utility).

HAI also utilized the Market Approach, which is defined by the *International Glossary* as "a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold."

Similar to the Coast Approach, the Market Approach is based upon the Principle of Substitution according to HAI. HAI utilized the Market Approach by referencing published operating cost benchmarks for Medicare Advantage plans to assess the reasonableness of (i) the PMPM fee in the first year derived from the Cost Approach; and (ii) the 12% cap beginning in year two of the Agreement.

HAI was provided with Soundpath audited income statements for the years ending December 31, 2008 through 2011 and internally-prepared income statements for the year-to-date period ending August 31, 2012. The historical income statements contained detailed premium revenue and operating expense information. For the eight month period ending August 31, 2012, HAI was provided with *member months* data, which was utilized to convert period-to-date revenue and expense values to a PMPM basis.[3]

HAI found that Soundpath's operating expenses as a percent of premium have generally declined during the period from a high point of 15.9% in 2008 to 11.9% in August 2012 year-to-date (a 25% decline). According to HAI, this is consistent with reasonable expectations that higher operating expense ratios will be observed during a company's start-up period, after which the company will realize cost efficiencies as fixed costs are spread across a larger customer base and revenue pool.

HAI was provided guidance regarding the fixed and variable nature of Soundpath's operating expense line items. HAI noted that this guidance was reasonable based upon its experience evaluating similar service arrangements.

HAI's analysis of the information provided results in its determination that the fair market value of the fee in year one as determined by the Cost Approach, which is intended to reflect the costs that will be incurred by CHPS during year one, is reasonably represented to be within a range between \$81.00 and \$85.00 PMPM (rounded).

To provide a reasonableness check on this fair market value range, HAI consulted cost benchmarks regarding the administrative costs of Medicare Advantage health plans published by the Sherlock Company ("**Sherlock**").[4] The Sherlock report provided insight into the administrative cost structures of plans that provided coverage to 2.2 million Medicare Advantage beneficiaries in 2010 (*i.e.*, approximately 18% of the Medicare Advantage market on a membership basis).

Expressed on a PMPM basis, the report determined the administrative costs of Medicare Advantage plans range from \$44.73 to \$86.36 at the median and 75th percentile, respectively. Thus, HAI's range of \$81.00 to \$85.00 is within a reasonable range reported by a large sample of market participants. This lends further support to the fair market value range derived by the Cost Approach.

In finding that the 12% cap for year two is reasonable and consistent with the fair market value standards, HAI considered the following:

1) SPH is currently running at an 11.9% operating expense ratio based on a review of August 2012 year-to-date financials.

2) While SPH has historically exhibited operating expense ratios in excess of the current run rate, it is HAI's belief that higher operating expense ratios are reasonable and expected during an entity's start-up period, after which the entity will realize cost efficiencies as it is able to spread costs over a larger customer base.

HAI noted that SPH continued to grow its membership base throughout 2012. Furthermore, HAI observed a declining trend in the operating expense ratio during the period between 2008 and 2012 year-to-date, which is consistent with the expectations described above.

3) This 12.0% cap is consistent with the representative administrative cost ranges exhibited by other Medicare Advantage plans in the marketplace as reported by Sherlock.

Based upon the analysis by HAI, HAI concluded that the fair market value of the administrative fee is as follows:

Year One: The fair market value of the administrative fee is reasonably represented as ranging between $81.00 and $85.00 PMPM.

Year Two: The administrative fee cap calculated as 12% of premium is consistent with fair market value and is commercially reasonable.

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[1] Defined by the *International Glossary of Business Valuation Terms* as accepted by the American Society of Appraisers and the National Association of Certified Valuation Analysts.

[2] 42 CFR §411.351 (as set forth by the Centers for Medicare and Medicaid Services or "CMS" with respect to physicians' referrals to healthcare entities with which they have financial relationships).

[3] A "member month" is equivalent to one month for which a member was active in the plan. For example, a member who was active in the plan for a period of one year would represent 12 member months.

[4] Administrative Costs for Medicare Advantage Plans Continue Moderating Trend in 2010, Plan Management Navigator, Sherlock Company, November 2011.