

Benefits Insights

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Health Insurance Tobacco Surcharges

As employers strive to manage health care costs and promote healthier lifestyles among their workforce, one strategy that has gained traction is the implementation of tobacco surcharges on health insurance premiums. These surcharges are permitted for qualifying health plans when they are part of a compliant wellness program. However, these requirements aren't always popular among employees. Some employees claim that these surcharges aren't compliant with federal laws, such as the Employee Retirement Income Security Act (ERISA), the Affordable Care Act (ACA), and the Health Insurance Portability and Accountability Act (HIPAA). In fact, a wave of recent ERISA class-action lawsuits are challenging tobacco surcharge programs in employer-sponsored health plans, focusing on potential ERISA fiduciary breaches.

This article provides an overview of tobacco surcharges and key employer considerations.

What Is a Tobacco Surcharge?

A tobacco surcharge, or a tobacco use surcharge or premium, is an additional charge imposed on employees who use tobacco products (e.g., smoke, vape and chew). This surcharge serves as a financial incentive to encourage employees to quit smoking or using other tobacco products. However, the [ACA and HIPAA require](#) that such surcharges be part of a compliant wellness program, providing tobacco users with a clear path to reduced premiums by meeting a reasonable alternative standard (RAS).

Under the ACA, group health plans and self-insured employers can charge tobacco users up to 50% more for their health insurance premiums than nontobacco users. Some states have limits on tobacco surcharges or even prohibit insurers from applying them, so employers should review

state-specific regulations to ensure compliance. Meanwhile, HIPAA and the Americans with Disabilities Act (ADA) impose additional protections to prevent discrimination and maintain that wellness program participation is voluntary.

Employer Considerations

The ACA divides wellness program activities into two groups: participatory and health-contingent. In a participatory wellness program, a participant earns incentives simply by participating. They are not expected to achieve a certain wellness goal. Conversely, health-contingent programs are outcomes-based and tied to a wellness goal, such as not using tobacco.

To comply with federal regulations, a wellness program imposing a tobacco surcharge must meet this [five-factor test](#):

1. **Annual opportunity**—Employees must have the opportunity to qualify for the lower premium at least once per year.
2. **Incentive limits**—The total premium difference must not exceed 50% of the total cost of employee-only coverage under the plan, with a 30% cap for other health-contingent incentives.
3. **Reasonable design**—The program must be reasonably designed to promote health or prevent disease, not to penalize the participant.
4. **RAS**—The program must offer a RAS (e.g., a tobacco cessation program) to avoid the surcharge.



5. **Clear communication of alternatives**—Employees must be informed about the availability of the RAS.

Common compliance pitfalls for employers involve the fine print around incentives and the RAS requirement. As such, lawsuits increasingly allege that some wellness programs fail to provide adequate alternatives or sufficient communication around tobacco surcharges, resulting in potential ERISA fiduciary breaches. Employees may view tobacco surcharges as discriminatory or argue that wellness programs breach ERISA fiduciary duties when surcharges are imposed without a clear health-promoting purpose.

In response, many employers can review their wellness program design and ensure it focuses on transparency and clear, accessible, reasonable alternatives (e.g., smoking cessation programs). Expanding beyond tobacco surcharges, employers should also regularly conduct reviews to ensure their workplace wellness programs align with ACA, ERISA and HIPAA requirements.

Keep in mind that some states—including California and New York—prohibit insurers from applying a tobacco surcharge and others may have surcharge limits. Employers should consult local legal counsel if they have questions about requirements in their state.

Summary

Implementing a tobacco surcharge on health insurance premiums is a strategy for employers who wish to include tobacco cessation as part of a wellness program to reduce tobacco use among employees. However, employers must carefully navigate the requirements, including federal and state-specific regulations, and provide adequate support and communication to ensure the success of their wellness programs.

Employers should consult local legal counsel before making any health plan updates related to tobacco surcharges or wellness programs. Contact us for additional benefits resources.