

A Guide to the Regulatory Flexibility Act

U.S. Small Business Administration
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Regulatory Analysis

Initial Regulatory Flexibility Analysis

The RFA requires federal agencies to consider the impact of regulations on small entities in developing the proposed and final regulations. If a proposed rule is expected to have a significant economic impact on a substantial number of small entities, an initial regulatory flexibility analysis must be prepared. The initial regulatory flexibility analysis or a summary of it must be published in the *Federal Register* with the proposed rule.

An initial regulatory flexibility analysis is prepared in order to ensure that the agency has considered all reasonable regulatory alternatives that would minimize the rule's economic burdens or increase its benefits for the affected small entities, while achieving the objectives of the rule or statute. The analysis describes the objectives of the proposed rule, addresses its direct and indirect effects and explains why the agency chose the regulatory approach described in the proposal over the alternatives.

Under Section 603(b) of the RFA, each initial regulatory flexibility analysis is required to address: (1) reasons why the agency is considering the action, (2) the objectives and legal basis for the proposed rule, (3) the kind and number of small entities to which the proposed rule will apply; (4) the projected reporting, recordkeeping and other compliance requirements of the proposed rule, and (5) all federal rules that may duplicate, overlap or conflict with the proposed rule.

While these five factors are necessary elements to an adequate MFA, they are not the sole factors necessary to perform an adequate analysis. Most important, section 603(c) requires that each initial regulatory flexibility analysis contain a description of any significant alternatives to the proposal that accomplish the statutory objectives and minimize the significant economic impact of the proposal on small entities. These alternatives could include the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; the use of performance rather than design standards; or an exemption from coverage of the rule or any part of the rule for small entities.

Although agencies often overlook this possibility, regulatory flexibility alternatives may include less stringent requirements for all regulated entities or for different classes of regulated entities. The section 603(c) analysis, a key part of the regulatory flexibility analysis, informs the decisionmaker of the pros and cons of each alternative, so he or she can make informed regulatory decisions.

The steps necessary under 603(b) include:

- 1) **A description of the reasons why action by the agency is being considered.** This is currently included in the preamble to all proposed regulations.
- 2) **A succinct statement of the objectives and legal basis for the proposed rule.** This is currently included with proposed rules.
- 3) **A description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply.** The agency describes the industry or economic sector in total and its small and large entity segments, includes a description of the industry or sector at the time of proposal, and explains any existing dynamics, such as trends in employment or birth of entities.

The definition of a small entity is an important element of this analysis. Agencies may either use the statutory definition of small entity or may propose an alternate definition in consultation with the SBA Office of Advocacy. The statutory small business definitions vary by 4-digit SIC code and are found at 13 CFR Part 121, last repromulgated in the January 31, 1996, Federal Register.

In the analysis, "small" entities may be further divided into multiple classes of small businesses, for example, 0-9, 10-49 and 50-500 employees. This segmentation allows the agency to differentiate different types of effects on different-sized small entities, which might lead to a different approach being applied to the very smallest entities.

The agency must include a description of the industries and economic sectors--as identified by, for example, their four digit Standard Industrial Classification Codes--that directly or indirectly would be affected by the proposed regulation.

- 4) **A description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule.** The description should include an estimate of the classes of small entities that will be subject to the requirement and the type of professional skills necessary for preparation of the report or record. This cost analysis should describe each item and estimate the costs, comparing large and small entities. It should distinguish the initial costs from recurring, or operating costs. This information normally should be available in large part from the paperwork burden analysis prepared under the requirements of the Paperwork Reduction Act.

- 5) **An identification, to the extent practicable, of all relevant federal rules that may duplicate, overlap, or conflict with the proposed rule.** This should include information for regulated entities on other rules governing the same activities.

Certification: Men a Full Analysis is Not Required

If a proposed rule is not expected to have a significant economic impact on a substantial number of small entities, either adversely or beneficially, the agency is not required to

perform an initial regulatory flexibility analysis. In these instances, the RFA authorizes an agency head to certify a rulemaking. To perform an adequate certification, an agency must undertake a threshold analysis to determine the economic impact of a proposed rule on small entities. Once this preliminary analysis is undertaken, an agency then can determine whether to certify or undertake a complete initial regulatory flexibility analysis.

The certification of a finding of no significant impact on a substantial number of entities must be published with the proposed rule in the *Federal Register*. The notice must be accompanied by an explanation of the factual basis for the certification. Under the 1996 amendments, the certification is subject to judicial review if the final rule is challenged.

There is currently no case law that identifies the "trigger" levels of "significant economic impact," or "substantial number of small entities." However, because the purpose of the analysis is to aid the decisionmaker in resolving regulatory issues affecting small entities, it is the opinion of the Office of Advocacy that any rulemaking that generates the interest of a significant number of small entities warrants the application of the RFA's analysis tools.

Final Regulatory Flexibility Analysis

When an agency issues any final rule, it must prepare a final regulatory flexibility analysis or certify that the rule will not have a significant economic impact on a substantial number of small entities. The final regulatory flexibility analysis must discuss the comments received, the alternatives considered and the rationale for the final rule. Either the summary or the final regulatory flexibility analysis itself must be published in the *Federal Register* with the final rule. Under the 1996 amendments, the final regulatory flexibility analysis is subject to judicial review if the final rule is challenged.

The new law amends the requirements of the final regulatory flexibility analysis contained in the original 1980 legislation. Each final regulatory flexibility analysis must contain the following:

- 1) A succinct statement of the need for and objectives of the rule;
- 2) A summary of the significant issues raised by public comments in response to the initial regulatory flexibility analysis, a summary of the agency's assessment of such issues and a statement of any changes made in the proposed rule as a result of such comments;
- 3) A description and an estimate of the number of small businesses to which the rule will apply or an explanation of why no such estimate is available;
- 4) A description of the projected reporting, recordkeeping and other compliance requirements of the rule, including an estimate of the classes of small entities that will be subject to the requirement and the types of professional skills necessary for the preparation of the report or record; and
- 5) A description of the steps the agency has taken to minimize the significant economic impacts on small entities consistent with the stated objectives of applicable

statutes, including a statement of the factual, policy and legal reasons for selecting the alternative adopted in the final rule, and the reasons for rejecting each of the other significant alternatives.

Again, the most important section is the analysis of the relative merits and demerits of the alternatives and the rationale for the final agency action. An agency may not simply rely on its preamble to the final rule to comply with the requirements for a final regulatory flexibility analysis. The RFA requires specific discussion of small entity alternatives designed to reduce adverse impacts or enhance the beneficial impacts of a rulemaking.

The RFA amendments modify the Administrative Procedure Act requirements by turning the consideration of small entity issues into a major component in rulemaking. Failure to fully comply with these requirements could result in arbitrary and capricious rulemaking.

The Office of the Chief Counsel for Advocacy believes that although agencies may not be legally required to perform an initial or final regulatory flexibility analysis on every rulemaking, agencies should aspire to perform these analyses for every rule that would have an economic impact on small entities. The act generally provides that agencies must prepare both an initial and final regulatory flexibility analysis for rules that may have a "significant economic impact on a substantial number of small entities." In practice, this requires agencies to prepare an analysis whenever a rule's impact on small entities cannot be described as *de minimis*. This practice will move away from speculative analysis towards more fact-based decisionmaking within the spirit of the law. We believe that an agency's resources should be shifted from the effort to determine whether regulatory flexibility analysis is required to the more productive consideration of regulatory options for small entities subject to the rule.