WHITE PAPER

Kentucky Sports Betting Market

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Executive Summary

Allocating problem gambling funds with a new law is not enough. Allocations only matter if they become expenditures on problem gambling resources, education and research. To ensure proper spending on problem gambling, Kentucky should consider three proactive steps in its sports betting implementation:

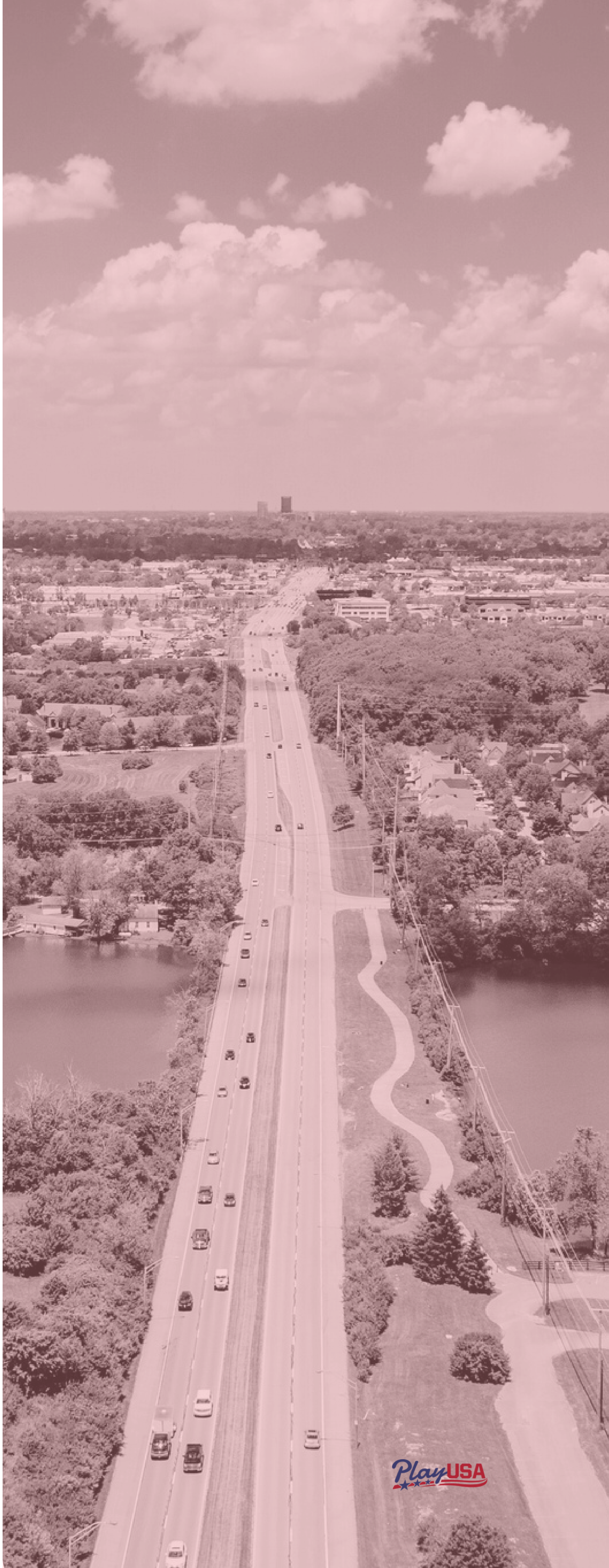
- Publish Problem Gambling Assistance Account deposits and expenses
- Communicate specific responsible and problem gambling programs to fund and sustain them
- Explore consumer empowerment programs to work on problem gamblers' behalf

The Sports Wagering Administration Fund will cover administrative sports betting costs and allocate 2.5% to the new Problem Gambling Assistance Account. The remaining money goes to the Kentucky Permanent Pension Fund.

Kentucky must also decide what it wants to accomplish with its problem gambling funds. Setting a benchmark for success is crucial for determining the efficient spending of problem gambling funds. However, Kentucky decided to spend its problem gambling funds, freeing the Kentucky Council on Problem Gambling to focus on complicated specialty issues, which marked an early success.

Finally, Kentucky should explore different ways that consumer empowerment programs can bring informed views on the public's interest to highly technical discussions of sports betting policy.

Complex issues for industry regulators won't be discernible to laypeople among Kentucky's voters. Ensuring that sports betting and, more broadly, online gambling regulations support the public interest rather than merely appear to do so will be critical to maintaining a modern online gambling industry.



Problem Gambling Spending is Low and Often Vulnerable

Public funding for problem gambling services is often an afterthought. The National Association of Administrators for Disordered Gambling Services (NAADGS) found that the **average per capita amount** on problem gambling services in the fiscal year 2022 was $0.38. Kentucky's sports betting bill contains the first allocations to problem gambling services in the state's modern history.

> Kentucky officials require oversight to ensure the state can direct those who need problem gambling services to access the resources they need for themselves and those affected by their gambling. While the KYCPG has performed this role for decades, an additional layer of oversight with direct authority over regulators could enhance the KYCPG's lobbying power.

However, expenditures on problem gambling services are what provide concrete benefits. When Arkansas created its state lottery in 2009, it allocated and spent $200,000 yearly on problem gambling services. In 2015, the legislature diverted those funds toward educational scholarships. The allocation in the bill was still $200,000, but it wasn't until a lawsuit that **problem gambling funds were restored** in December 2021.

Other states siphon off problem gambling funds to fill shortages in other state budget areas. **NAADGS' 2021 Survey of Publicly Funded Problem Gambling Services** found that "historically, problem gambling services have received less than 10% of the [Problem Gambling And Other Addictions Fund] annual revenue." Over 90% of Kansas's funds went to substance abuse or other areas of the general fund.

Kentucky should avoid underfunding its new problem gambling services by publishing Problem Gambling Assistant Account deposit and expense reports. Monitoring them will ensure that problem gambling funds are being deposited and maximized before the deduction of administrative expenses from the Sports Wagering Administration Fund. Kentucky journalists will also be able to effectively monitor the use of state problem gambling funds.

Opportunity to expand assistance

Kentucky regulators should also communicate the specific problem gambling programs they want to free the Kentucky Council on Problem Gambling (KYCPG) chapter from funding. The KYCPG is currently Kentucky's sole provider of problem gambling services. The state now has the opportunity to ensure that the basic infrastructure of problem gambling care, like the helpline and sufficient counselors, is available to problem gamblers seeking treatment. The KYCPG could then evolve to meet additional state needs, including but not limited to niche issues like youth gambling education and complex relationships between legal advertising and illegal sportsbook traffic.

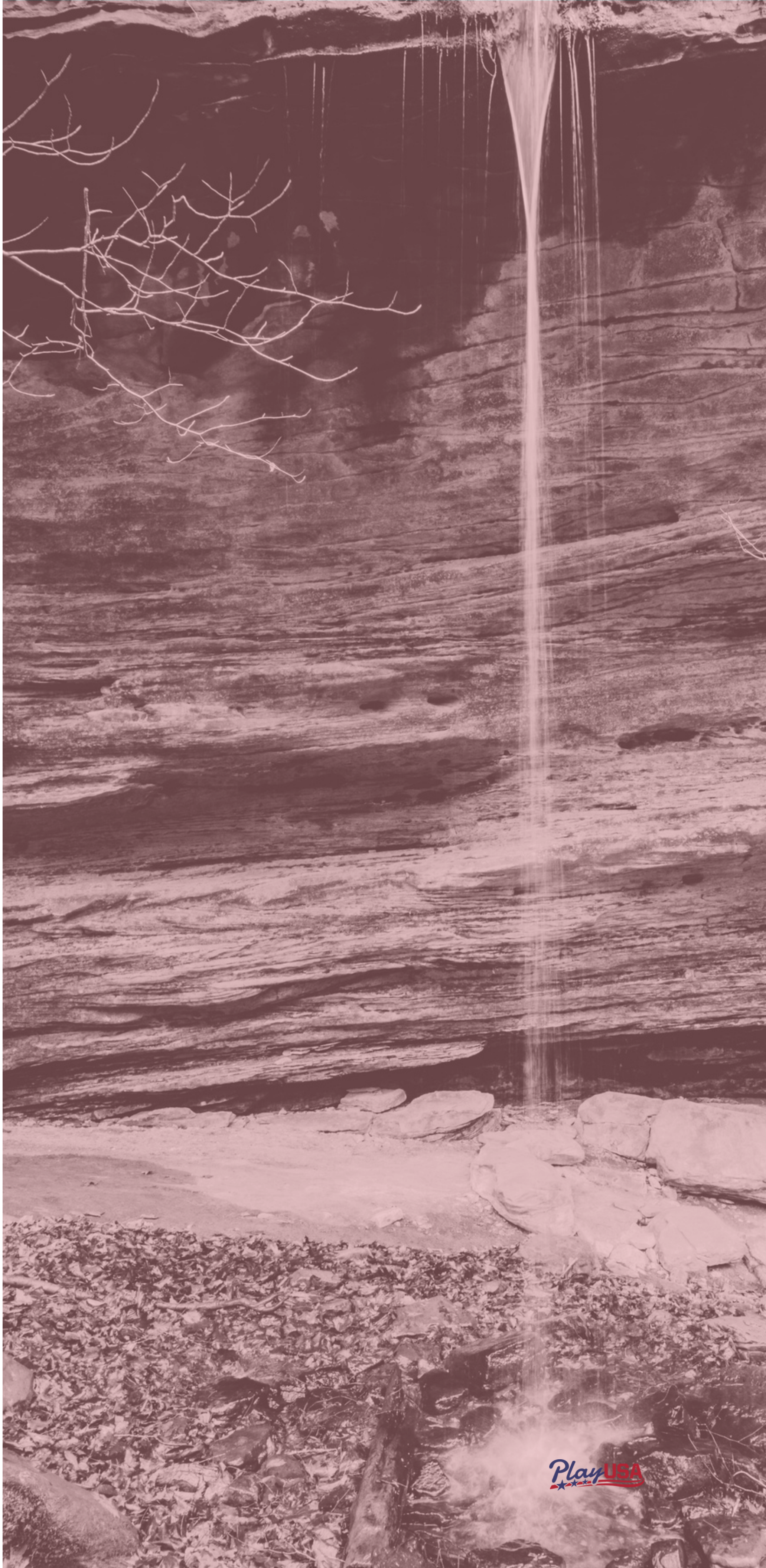
Finally, Kentucky should consider creating a proxy advocate responsible for ensuring adequate problem gambling care is available to Kentucky residents.

Additional oversight

While helpline access and counselor cross-training are valuable, someone has to ensure that the helpline can handle the state's call volume and that counselors know they have the option to undergo additional training to become licensed to treat problem gambling patients.

While Kentucky's allocation of public funds to combat problem gambling is laudable, putting all the burden of funding problem gambling services on the KYCPG reduces the non-profit's ability to use its expertise to address complex problems rather than solely fund essential services.

Kentucky officials require oversight to ensure the state can direct those who need problem gambling services to access the resources they need for themselves and those affected by their gambling. While the KYCPG has performed this role for decades, an additional layer of oversight with direct authority over regulators could enhance the KYCPG’s lobbying power.



Monitor Problem Gambling Assistance Deposits, Expenses

Kentucky's new Sports Wagering Administration Fund will receive money from license fees, application fees and sports betting tax revenue. Money from that fund will be able to pay for "administrative expenses relating to or associated with the purposes of sports wagering," problem gambling funding and pension funding. Further, **Section 8, subsection 3, clause (a)** states:

"The expenses of the commission and the compensation of all employees referred to in this section shall be paid by the licensee conducting a horse race meeting or pari-mutuel wagering on live or historic horse racing, provided that the expenses of the commission and the compensation of employees under this section related to administering the system of sports wagering shall be paid by the sports wagering administration fund established in Section 1 of this Act."

The initial $500,000 license fees would add several million to the Sports Wagering Administration Fund. Annual tax revenue could add another $23 million to $34 million annually to the fund. **Gaming Today reported** that while the Governor's office estimated $23 million in annual tax revenue, industry analysts Eilers & Krejcik Gaming estimate that annual sports betting tax revenue could reach $34.2 million by 2027.

The **sports betting regulations' fiscal notes** estimate that the first year of sports betting administration would cost $2.4 million, and each following year would cost $1.2 million. On its face, that appears to leave millions for pension funding and problem gambling services.

Only $25,000 out of every $1 million in the Sports Wagering Administration Fund will go to the Problem Gambling Assistance Account.

First Year Administrative Cost

$2.4 Million

The Kentucky Horse Racing Commission estimates that the first year of sports betting administration would cost $2.4 million, and each following year would cost $1.2 million.

Total Annual Tax Revenue

$23 Million

Kentucky state officials expect a $23 million annual tax payout from legal sports betting "at full implementation", according to Gov. Andy Beshear's office.

However, out of every $1 million in the Sports Wagering Administration Fund, only $25,000 will go to the Problem Gambling Assistance account. Further, to spend the average amount of money allocated to problem gambling per capita, $0.38, Kentucky would need to spend about $1.7 million on problem gambling services. That would require $68.5 million in the Sports Wagering Administration Fund, assuming that problem gambling funds were deposited first.

As enacted, HB 551 does not guarantee that administrative expenses can be made before money is deposited into the Problem Gambling Assistance account.

Former state representative Adam Koenig's first attempt at a sports betting bill included an amendment that **required problem gambling funds** to be deposited before administrative funds. Still, it was defeated along with the bill and wasn't reintroduced in the final sports betting bill that Rep. Michael Meredith sponsored over three years later.

While the bill's authors have stated that problem gambling funds will be deposited first, publishing the deposit and expense data for the new Problem Gambling Assistance Account would ensure that promise is kept without a large bureaucratic expansion.

That transparency would ensure that journalists, non-profits, and consumer advocates could assess whether administrative funds were legitimately tied to sports betting and not being used to cover unrelated expenses.

Such a ledger would indicate corruption or waste that may creep into state expenses over time. Considerable expenses that don't correspond with an equally important investment would be easier to spot. Auditors, journalists, and non-profits could find and investigate small costs that accumulate over time and have little to do with managing sports betting.

Finally, these reports would have to be publicly available, similar to sports betting revenue reports in other states. Kentucky no doubt has a plan to publish sports betting revenue reports, as every other state with legalized sports betting does. Problem Gambling Assistance Account expense reports should be published alongside them to be easily accessible to the public instead of buried on a government website.

Demand Specificity in Problem Gambling Proposals

Kentucky won't be able to declare its problem gambling funding plan successful without a benchmark to measure success. Having failed to allocate public funds to confront problem gambling, creating any new program can be billed as a win. However, that bar is too low to measure progress against.

Overly pessimistic readings of Kentucky's problem gambling spending aren't more reasonable. If it doesn't become a national leader in nuanced problem gambling research, Kentucky won't fail in its problem gambling responsibilities. The presence of problem gamblers and patients with gambling disorders isn't evidence of failure, either.

Although the Cabinet for Health and Family Services has promulgated regulations governing how problem gambling funds may be spent, clear goals for what the money should accomplish are also required.
One significant accomplishment would be freeing the KYCPG from funding foundational problem gambling programs, like the problem gambling helpline.

Kentucky's problem gambling investments should be funded at a minimum:

- State problem gambling helpline
- Counselor cross-training
- Public education and ongoing surveys

The first two programs are foundational in the problem gambling pipeline. While Kentucky cannot force every problem gambler into treatment, the state can ensure that resources are available for those seeking treatment or nudging others into treatment.

The problem gambling helpline directs callers to counselors, gambling anonymous groups, and other resources. The helpline can also provide crisis counseling for suicidal callers. Counselor cross-training ensures that licensed therapists can also serve problem-gambling clients. Gambling counselors receive their accreditation for two essential reasons.

First: Training for Counselors

First, addiction counseling requires a unique set of skills. One of the **diagnostic criteria** for gambling disorders is that the patient is lying to conceal the problematic behavior. Counselors must have access to training for this patient-provider dynamic.

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Second: Busting Myths

Second, patients with gambling disorders have unique needs that substance abuse and even other behavioral addiction programs don't meet. Part of gambling disorder treatment involves financial literacy, which dispels myths that lead patients to overestimate their chances of winning and to chase losses.
Busting those myths is necessary for gambling disorder treatment's cognitive behavioral therapy component.

Together, the problem gambling helpline and counselor cross-training can create a bedrock to support the problem gambling inquiries driven by a new and popular form of online gambling. Public education campaigns that dispel gambling myths can reinforce this foundation.

Third: Ongoing surveys

To plan for future needs, the Division of Behavioral Health should fund ongoing surveys to monitor reported problem gambling levels and consequences. Surveys can reveal underlying issues that can be addressed after Kentucky establishes its first publicly funded problem gambling programs.

For example, Illinois published the results of a **statewide problem gambling survey** in July 2022. It found that 3.8% of Illinois adults were "considered to have a gambling problem." Another 7.7% were "at risk for developing a gambling problem."

The full report also included 10 recommendations for combating problem gambling in Illinois. Kentucky could pursue similar lines of research on an ongoing basis to ensure that it meets its obligations to problem gamblers. This new public funding does not mean gambling companies should stop funding the KYCPG.

Most of the KYCPG's current revenue comes from donations from the gambling industry. This is how the gambling industry pays some of the negative costs associated with gambling expansion. Maintaining this revenue stream would allow the KYCPG to expand on its current offerings rather than replace one revenue stream with another.

One of the crucial roles the KYCPG can play is researching and addressing complicated, nuanced and niche issues, such as the impact of legal sportsbook advertising on underage college students and registration at offshore sportsbook sites. Nonprofits are better suited to disentangle complex issues and formulate policy recommendations.

However, the KYCPG can't formulate policy solutions to push lawmakers when their funds are tied up with essential services. Its capacity is also limited if it lacks additional funding for increased staffing. If the KYCPG can fund research into specialty issues, then the Kentucky government can reasonably claim that the state's initial problem gambling programs were, by at least one measure, successful.

Explore Consumer Empowerment Programs

Regulatory capture is more nuanced than an industry taking over a regulatory agency. For example, cultural capture refers to the "capture" that can occur when regulators and industry members work alongside one another for long periods and regulators come to identify with members of the industry.

In Daniel Carpenter's and David Moss' book Preventing Regulatory Capture, James Kwak's article on cultural capture and the financial crisis argues that this occurred between financial regulators and bankers leading up to the 2008 financial crisis. Kwak quotes a 2010 interview with the chair of the UK Financial Services Authority, Adair Turner, in which Turner "describe[d] the tendency of financial regulators to engage in 'problem-solving with the [regulated] industry' rather than enforcing existing rules."

Nolan McCarty's article argues that information capture can occur when government agencies rely on the industry they regulate for crucial data. "Regulators may be so extremely dependent on the industry for information, expertise, and talent that they cannot exercise independent regulatory authority," McCarty wrote.

In the ways mentioned above, the horse racing industry does not control the Kentucky Horse Racing Commission. Lawmakers who receive campaign contributions from the horse racing industry may be influenced to write laws and regulations that address the industry's interests and concerns.

However, regulators and lawmakers aren't "captured" because they serve an industry's interests. To capture their regulators, the regulated industry must consistently steer policies away from the public's interests. Kentucky's horse racing industry seems to exercise what Carpenter and Moss call weak capture, an influence counteracted by competing forces.

A consumer empowerment program in Kentucky could take the form of proxy advocacy, as Daniel Schwarcz's article in Preventing Regulatory Capture suggested. Proxy advocacy would create an "independent government [entity]...tasked with representing the public interest in designated regulatory proceedings."

A straightforward solution could be designating lawyers or a department within the Kentucky Attorney General's office to monitor the impact of Kentucky's public problem gambling program funding. These officials could ensure that primary care is available through Kentucky's problem gambling expenditures without requiring the public to become well-versed in detailed policy discussions about counselor cross-training or advertisement frequency.

These empowered officials could demand that specific problem gambling care issues be addressed in gambling regulation and spending, wielding influence in the rulemaking process. It can also hold the officials in charge of spending Problem Gambling Assistance Account money accountable for the availability of problem gambling treatment in Kentucky.

Finally, officials within the Attorney General's office would be separated from the industry they monitored. This separation will help prevent a type of capture that leads regulators and lawmakers to problem-solve with the industries they regulate rather than regulate them.

Further, this new layer of oversight could complement the lobbying and dialogue that the KYCPG already has with government officials. The KYCPG has the expertise to evaluate state spending's effectiveness in combating problem gambling. A state authority that can issue fines, conduct investigations, and defer to the KYCPG's expertise could be a powerful force for improved public spending.

Since this approach depends on regulatory shortcomings, exploring a contingency plan rather than a recommendation will establish Kentucky sports betting for success.

More Gambling Expansion Attempts Are Coming to Kentucky

Kentucky is well-positioned to launch a sports betting industry that benefits many stakeholders. The horse racing industry will get new streams of revenue. Kentucky will also generate new tax revenue without raising taxes on its citizens.

However, maintaining a healthy sports betting industry is more complex than launching one. Tracking allocations to the new Problem Gambling Assistance Account will be easy. Monitoring the services, campaigns, consultants, and other expenses is a challenge that any state must meet.

When NAADGS conducted its state-by-state survey comparing bill allocations and expenditures in 2021, their methodology included financial documents and interviews with state government workers who could identify unpaid expenses.

In that survey, Kentucky was one of nine states that did not allocate public funds toward problem gambling services. HB 551's passage has ensured that Kentucky is no longer among that group of states.

Efforts to expand online gambling are far from over. Sportsbook companies are eying online casino markets to open, which are far more profitable than sports betting markets.

The horse racing industry will likely monitor developments in other states to gauge how it can lobby to offer new types of gambling.

Online casinos won't spread as quickly as sportsbooks, especially in Kentucky, the 37th state to legalize sports betting. It would also be difficult to formulate a type of online casino that conforms with Kentucky's state constitution, which only allows parimutuel wagering.

Nevertheless, Kentucky could be less than a decade away from another attempt at gambling expansion.

Kentucky will also generate new tax revenue without raising taxes on its citizens.

With that in mind, it's critical for Kentucky to ensure that its problem gambling allocations become problem gambling expenditures that allow the state to keep up with new research and the following challenges.

Problem gambling can harm Kentuckians, even if they are not problem gamblers. Suppose Kentucky wants the economic growth that comes from a newly taxable industry. In that case, it will do well to maintain the economic productivity of a public unencumbered by theft, bankruptcy and suicide produced by severe gambling addictions.

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