

SEC enforcement action highlights scrutiny of "alternative data" and trading firms that use it

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[An enforcement action against an alternative data provider for misrepresenting its practices offers lessons both for trading firms that use alternative data and public companies that sell it.](#)

On September 14, 2021, the Securities and Exchange Commission [announced a settlement](#) with App Annie Inc., a privately held company, and its co-founder and former CEO and Chairman for making material misrepresentations about how App Annie obtained alternative data—information about companies or investments that is not contained within financial statements or other traditional data sources—and about its internal controls to prevent the misuse of confidential data.

App Annie provides a free performance analytics product for mobile applications. In exchange, app developers, including public companies, permit App Annie to collect confidential app performance metrics. App Annie's Terms of Service stated that it would only use a developer's confidential app performance metrics in an aggregated and anonymized form to generate estimates of app performance.

App Annie sold its app performance estimates to securities trading firms. The SEC found that App Annie reassured developers using its product and trading firms purchasing its data that it abided by its representations about aggregating and anonymizing data and that it derived its estimates via a statistical model that combined this data with publicly available information. App Annie also provided additional reassurance to trading firms that it maintained processes and controls to prevent the misuse of confidential information.

The SEC found that App Annie instead used *non*-aggregated and *non*-anonymized confidential data, including public company app performance metrics, to improve the estimates it sold. The SEC found that App Annie engineers used confidential data to make manual changes to estimates generated by its statistical model so the estimates would more closely reflect actual app performance. App Annie also compared the model-generated estimates for some apps to their **actual** confidential performance figures. When the model-generated estimates were not close enough to the actual performance metrics, App Annie arbitrarily cut the difference by half and replaced the model-generated estimates with the more accurate numbers before selling the data to trading firms. The SEC concluded that this violated the consent App Annie obtained from public company app developers and misled the trading firms. Without admitting or denying the findings, App Annie and its co-founder and former CEO and Chairman consented to pay civil penalties of \$10 million and \$300,000 respectively.

App Annie did not purchase or sell any securities using the estimates. However, the order concluded that the conduct was sufficiently connected to the purchase or sale of securities, and therefore within the scope of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, because App Annie encouraged firms to trade on the data, and the trading firms did so. After the SEC announced the case, SEC Commissioner Hester Peirce tweeted that the case "stretches the 'in connection with the purchase and sales of securities' requirement under 10b/10b-5 beyond where I think it should go."

Takeaways

The case has several important takeaways for trading firms that use alternative data and public companies that provide data to alternative data vendors:

- The SEC is focused on policing the use of alternative data. Although this case focused on a data vendor, the SEC has examined trading firms' use of alternative data and could bring future enforcement actions targeting controls around the use of alternative data. The SEC's 2020 Examination Priorities stated that examinations would "focus on firms' use of [alternative] data sets and technologies to interact with and provide services to investors, firms, and other service providers and assess the effectiveness of related compliance and control functions."
- Trading firms that use alternative data should be prepared to demonstrate that they have reasonably designed policies and procedures to prevent the misuse of this information. These procedures can include representations from data vendors about their sources of data and their authority to sell it for trading purposes, and potentially doing due diligence, when possible, about the vendors and how they obtain data.
- Public companies that provide alternative data to third-party vendors should be mindful of its potential misuse. Although companies may not be able to prevent vendor misrepresentations, agreements to sell data should include clear provisions that detail acceptable uses and provide remedies if vendors violate these provisions. For example, contracts can specify whether the data may be used for trading, or whether its use, including by third parties, is restricted to non-trading purposes.

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