

## SEC Enforcement Case Summary

### Crypto-Focused Private Fund Manager Charged with Custody Rule Failures & Misleading Redemption Practices Following FTX Collapse

On September 3, 2024, in a groundbreaking case, the SEC charged Florida-based private fund manager Galois Capital Management LLC with violations of the Custody Rule 206(4)-2 under the Investment Advisers Act of 1940 (the Advisers Act) when it failed to hold crypto assets at a qualified custodian. Galois managed a private hedge fund that invested primarily in crypto assets held in online trading accounts on crypto asset trading platforms that were not banks, registered broker-dealers, nor another category of qualified custodian as defined under the Custody Rule. In particular, Galois maintained certain fund crypto assets at FTX Trading Ltd. FTX was the third-largest crypto exchange when it collapsed within a matter of days in November 2022. Galois lost approximately half of the fund's assets under management in connection with the collapse of FTX.

Galois was further faulted for preferential treatment and disclosure failures surrounding its redemption practices. The fund's limited partnership agreement provided that a partner could redeem from the fund as of the last day of any calendar month with 30 days' written notice to the general partner, unless the general partner approved a shorter notice period. Galois had an informal practice of permitting redemptions with less than 30 days' notice if investors provided at least five business days' notice prior to month end. Galois communicated this informal practice to certain investors, including investors who asked Galois about the redemption notice period or submitted redemption requests with less than 30 days' notice. However, the firm did not inform all investors about this informal practice. In addition, Galois approved certain redemption requests with less than five business days' notice for certain investors, including affiliated investors.

Although Galois was registered as an investment adviser for less than six months, the SEC charged the firm with failing to adopt or implement written compliance procedures as required under the Compliance Rule 206(4)-7. The Galois case is notable as the first Custody Rule case focused on digital assets, and it also highlights the SEC's focus on preferential treatment, a topic that was at the center of the recent Private Fund Rules that were vacated in May 2024. In addition, this action demonstrates that the SEC can and will still bring enforcement under the Private Fund Fraud Rule 206(4)-8 for abusive preferential treatment practices.

The Galois fund is currently in the process of winding down. Galois agreed to pay a civil penalty of \$225,000 to settle the SEC's charges, which will be distributed to its fund's harmed shareholders.

See Summary - <https://www.sec.gov/newsroom/press-releases/2024-111>