Re Red Cloud Securities

IN THE MATTER OF:

The Investment Dealer and Partially Consolidated Rules and the Dealer Member Rules

and

Red Cloud Securities Inc.

2023 CIRO 05

Canadian Investment Regulatory Organization
Hearing Panel (Ontario District)

Heard: July 12, 2023, in Toronto, Ontario via videoconference
Decision: July 12, 2023
Reasons for Decision: July 18, 2023

Hearing Panel:
Christopher Bredt, Chair, Colleen Wright and Tim Pryor
Appearances:
Sylvia Samuel, Senior Enforcement Counsel
Robert Staley, for Red Cloud Securities Inc.
Meg Bennett, for Red Cloud Securities Inc.

REASONS FOR DECISION

INTRODUCTION

¶ 1 This is a settlement hearing to determine whether to accept or reject the terms of a settlement agreement which has been entered into between the staff of the Canadian Investment Regulatory Organization ("CIRO") and the Respondent, Red Cloud Securities Inc. ("Red Cloud"). At the conclusion of the hearing, having given consideration to the IIROC sanction guidelines and previous decisions, the Panel found that the settlement agreement was within a reasonable range of appropriateness. Accordingly, the Panel accepted and endorsed the Settlement Agreement with written reasons to follow. These are our reasons.

OVERVIEW

¶ 2 Prior to January 30, 2020, Red Cloud was an Exempt Market Dealer regulated by the Ontario Securities Commission. As an Exempt Market Dealer, Red Cloud engaged in retail private placements.

¶ 3 On January 30, 2020, Red Cloud became a Dealer Member of the Investment Industry Regulatory Organization of Canada ("IIROC"), one of the predecessors of CIRO, limited to servicing institutional clients and was required to give up its registration as an Exempt Market Dealer. On April 7, 2020, Red Cloud applied to IIROC to obtain approval to service retail investors. IIROC approved the servicing of retail investors on October 26, 2020.

¶ 4 In the period between January 30, 2020 and October 26, 2020, Red Cloud serviced retail clients although not approved by IIROC to do so. In this period, Red Cloud did not have any representative registered with the required proficiencies to service retail clients.

¶ 5 Between January 30, 2020 and October 26, 2020, the Know-Your-Client ("KYC") documentation used by

Red Cloud did not meet IIROC requirements.

¶ 6 Between February 2020 and August 2021, Red Cloud sold or facilitated the sale of private placements to approximately 192 different retail investors, but failed to establish and maintain a system of controls and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to prospectus exempt distributions, particularly the accredited investor exemption.

¶ 7 Further, Red Cloud conducted the private placement transactions off book, and did not, until August 2021, consistently open client accounts on Red Cloud's books, or obtain signed client account agreements, or issue trade confirmations or monthly account statements, and, until August 2021, Red Cloud failed to maintain sufficient evidence of supervision or to have proper books and records to permit adequate supervision.

¶ 8 None of the clients engaged in the retail private placement transactions between February 2020 and August 2021 were harmed, and since August 2021, Red Cloud has taken steps to remediate and rectify the contraventions.

Settlement Agreement

¶ 9 On June 21, 2023, Red Cloud entered into an agreement with CIRO (the "Settlement Agreement"). The Settlement Agreement is attached as an Appendix to this decision. In the Settlement Agreement, Red Cloud has admitted to the following contraventions:

1. Between February 2020 and August 2021, Red Cloud permitted persons to act on behalf of the Dealer Member without proper approval, contrary to Dealer Member Rule 18.2.
2. Between February 2020 and August 2021, Red Cloud failed to process all of its activity related to the sale of securities to retail clients through private placements on its books and records, contrary to Dealer Member Rules 17.2 and 200.2.
3. Between February 2020 and August 2021, Red Cloud failed to establish and maintain a system of controls and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to prospectus exempt distributions, contrary to Dealer Member Rules 38.1, 1300.2, and 2500 (II).

¶ 10 Red Cloud has agreed to the following sanctions and costs:

1. disgorgement in the amount of $611,306.18;
2. a fine in the amount of $100,000; and
3. costs in the amount of $15,000.

¶ 11 We summarize below, the key elements of the misconduct admitted to by Red Cloud as set out in more detail in the Settlement Agreement.

Red Cloud Becomes Dealer Member

¶ 12 By application dated August 16, 2019, Red Cloud applied for approval as an IIROC Dealer Member. Its application indicated a limited business line of corporate finance underwriting/sales, mergers and acquisitions/advisory and research, with its principal business devoted to institutional clients.

¶ 13 During the process of membership review, Red Cloud represented to IIROC that it did not intend to have retail clients but might consider having retail clients in eighteen to twenty-four months and would seek IIROC approval prior to such a change.

¶ 14 On January 30, 2020, IIROC approved Red Cloud as a Dealer Member.

Red Cloud Approved for Retail

¶ 15 On or about April 7, 2020, Red Cloud applied for approval for retail trading and indicated that the trade activity would be limited to deals underwritten by Red Cloud.

¶ 16 On or about October 26, 2020, IIROC advised Red Cloud that it did not object to Red Cloud adding a new

line of business for the distribution of securities to retail clients as an underwriter, part of an underwriting syndicate, or a selling agent for an underwritten transaction. IIROC also advised that its non-objection was subject to Red Cloud's proposed Registered Representatives meeting all retail proficiency requirements.

¶ 17 However, as set out below, prior to its approval for retail on October 26, 2020, Red Cloud had already engaged in approximately 25 private placements that involved purchases by retail clients.

Registration and Approval of Red Cloud's Employees

¶ 18 Until December 8, 2020, none of Red Cloud's employees were registered to deal with retail clients.

¶ 19 On or about December 8, 2020, two Red Cloud employees became registered as Registered Representative, Retail. On or about January 2021, another three Red Cloud employees obtained IIROC registration and approval to deal with retail clients. In or about August 2021, an additional employee obtained IIROC registration and approval to deal with retail clients.

Red Cloud Dealings with Retail Clients Prior to Approval

¶ 20 Starting in February 2020, Red Cloud engaged in private placements that involved subscriptions by retail clients, and, by August 2021, had engaged in approximately 77 such private placements.

¶ 21 Between February 2020 and August 2021, Red Cloud sold or facilitated the sale of private placements to approximately 192 retail investors.

Red Cloud Dealt with Retail Clients Prior to Approval for Retail

¶ 22 Prior to its approval for retail on October 26, 2020, Red Cloud had already engaged in approximately 25 private placements that involved purchases by retail clients and received fees in connection with these distributions of securities.

Red Cloud Dealt with Retail Clients Before Employees Registered for Retail

¶ 23 The 29 deals that occurred between February 2020 and December 8, 2020, occurred before any of Red Cloud's employees were registered or approved to deal with retail clients.

¶ 24 The 48 deals that occurred on or after December 8, 2020, occurred while some of Red Cloud's employees were registered and approved to deal with retail clients, but the Red Cloud employees with whom the clients dealt in respect of these deals were not registered and approved to deal with retail clients in all cases.

Red Cloud's Failure to Maintain Books and Records

¶ 25 In the 77 deals that occurred between February 2020 and August 2021, Red Cloud failed to adequately record the trading activity on its books and failed to otherwise maintain adequate books and records related to this activity.

¶ 26 On or about January 26, 2021, IIROC approved the bulk transfer of Red Cloud client accounts to Red Cloud's new carrying broker.

¶ 27 With its new carrying broker, Red Cloud then began a process of opening accounts for clients, with the first account statements being issued for the period February 2021.

¶ 28 Prior to transfer to the new carrying broker, Red Cloud failed to process any of the private placements on its books.

¶ 29 Even after February 2021, Red Cloud continued to sell securities to clients by way of private placements without, in some cases, opening client accounts or issuing trade confirmations or account statements. Red Cloud did so until August 2021.

Red Cloud's KYC Failures

¶ 30 Red Cloud did not update its KYC documentation when it became a Dealer Member on January 30, 2020. Consequently, the KYC documentation used by Red Cloud did not meet IIROC requirements.

¶ 31 Until about August 2021, Red Cloud failed to consistently collect client information in a manner consistent with its KYC obligations.

¶ 32 Further, as private placements, the deals in which Red Cloud engaged were not qualified by prospectus, and, therefore, only permitted to be distributed pursuant to prospectus exemptions.

¶ 33 From February 2020 to August 2021, Red Cloud sold securities to retail clients primarily pursuant to the accredited investor prospectus exemption in s. 2.3 of National Instrument 45-106 Prospectus and Registration Exemptions.

¶ 34 Prior to August 2021, Red Cloud's process to determine whether clients were able to rely on a valid prospectus exemption, such as the accredited investor exemption, was inadequate.

¶ 35 Red Cloud did not have an adequate process in place by which Red Cloud would check whether the client's KYC information matched the criteria indicated on the accredited investor forms to confirm whether the prospectus exemption was available to the client.

¶ 36 Further, Red Cloud failed to maintain sufficient evidence that it had reviewed the client's eligibility to claim accredited investor status.

Supervision Failures

¶ 37 Between January 2020 and February 2021, Red Cloud did not have Supervisors responsible for new accounts openings, including the completion of new account forms, or subsequent account supervision.

¶ 38 Between June 30, 2020 and May 25, 2021, a series of different individuals were appointed to the role of Chief Compliance Officer and others were appointed as Supervisors, but there continued to be gaps in the supervision of the trades conducted by Red Cloud on behalf of retail clients.

¶ 39 Further, Red Cloud failed to maintain proper or adequate books and records by which Supervisors could properly review trading activity.

¶ 40 In particular, between February 2020 and August 2021, Red Cloud failed to establish and maintain a system of control and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to the accredited investor prospectus exemption.

Fees and Compensation

¶ 41 Between February 2020 and August 2021, Red Cloud received compensation (commissions and warrants) in connection with securities purchased by its retail clients by private placement while Red Cloud was not compliant with its regulatory obligations under IIROC rules, including the following:

(a) Red Cloud received fees of $277,464.94 and warrants of 3,192,325 with a realized value of $79,352.46 for transactions prior to October 26, 2020, when the firm became licensed to deal with retail clients. The remaining warrants have either expired or are worthless;

(b) Red Cloud received fees of $12,014.04 and warrants of 27,116 with a realized value of zero dollars, with the warrants expired worthless for transactions between October 26, 2020 and December 8, 2020, when the first Registered Representative ("RR") was approved to deal with retail clients; and

(c) Red Cloud received fees and warrants for transactions between December 8, 2020 and August 2021 of which:

(i) fees of $224,690.30 and 1,316,990 warrants with a realized value of $6,164.45 were for transactions where the client was not dealing with an RR registered for retail, including where the client was either a Red Cloud affiliate (no fees charged) or an employee of Red Cloud, and no Red Cloud account was opened for the client; and

(ii) fees of $11,619.99 and 54,542 warrants with a realized value of zero dollars, with the warrants expired worthless were for transactions where the client was not dealing with

an RR but a Red Cloud account was opened. Seven of these eight instances involved either a Red Cloud affiliate or one of Red Cloud's executive. The fees are in respect of transactions where the client was a Red Cloud Executive. Fees were not charged in connection with Red Cloud affiliates.

¶ 42 Red Cloud received fees of $100,106.41 and 483,008 warrants with a realized value of zero dollars, with the warrants expired worthless for all transactions between December 8, 2020 and August 2021 where the client dealt with an RR registered for retail and had a Red Cloud account.

ANALYSIS

¶ 43 This proceeding raises the following issues:

(i) the test for acceptance of a settlement agreement;

(ii) review of the IIROC Sanction Guidelines; and

(iii) previous regulatory decisions.

(i) Test for Acceptance of a Settlement Agreement

¶ 44 It is well accepted that, in considering a settlement agreement, a hearing panel's task is to decide whether the agreed sanctions fall within a "reasonable range of appropriateness". The Panel is not to decide whether it would have imposed the same sanctions as those negotiated by the parties, nor is it to modify or alter the sanctions. [1]

¶ 45 Accordingly, in considering the acceptance of a settlement agreement, a hearing panel must be satisfied that the agreed sanctions are within an acceptable range, are fair and reasonable, and serve as a deterrent to the respondent and to the industry. A hearing panel should accept the settlement agreement where it is in the public interest to do so.[2]

¶ 46 In applying the "reasonable range of appropriateness test" hearing panels consider the IIROC Sanction Guidelines, previous regulatory decisions, and any other relevant matters.

(ii) IIROC Sanction Guidelines

¶ 47 A hearing panel is to consider the IIROC Sanction Guidelines ("Guidelines") in determining whether the agreed sanctions in a settlement agreement fall within a reasonable range of appropriateness. The Guidelines set out general principles that provide a framework that should be considered in connection with the imposition of sanctions as well as key factors commonly taken into consideration when making a determination of the appropriateness of sanctions.

¶ 48 The Guidelines make it clear that the purpose of sanctions in a regulatory proceeding is to protect the public interest by restraining future conduct that may harm the market. Sanctions should be significant enough to prevent and discourage the respondent from engaging in future misconduct (specific deterrence) and to deter others from engaging in like misconduct themselves (general deterrence). To achieve this balance, the panel must consider whether the penalties are proportionate to the conduct at issue, as well as mitigating and aggravating factors.

¶ 49 The following are the key factors outlined in the Guidelines that we considered in determining that the agreed sanctions were appropriate in this case:

- The misconduct relates to 77 different private placements and involved 192 retail clients;
- The misconduct took place, to varying degrees, from February 2020 to August 2021 (approximately 18 months);
- The Respondent engaged in activity with retail clients after making representations to IIROC during the membership approval process, that it did not intend to have retail clients but may consider

[1] *Milewski (Re)*, [1999] 1.D.A.C.D. No. 17 at p 10.

[2] *Re Donnelly* 2016 IIROC 23 at paras 7-8.

having retail clients in 18 to 24 months and would seek IIROC approval prior to such changes;

- Although the Respondent applied for IIROC approval of its retail business (which indicates an awareness of the requirement), it proceeded to conduct retail business prior to obtaining approval;
- There is no evidence of client harm and no complaint alleging any such harm;
- There is no evidence of vulnerability. The regulatory breach relates to the firm's dealing with accredited investors;
- The Respondent has no disciplinary history so as to warrant harsher sanctions;
- The Respondent obtained significant financial benefit as a result of its misconduct. It has, however, agreed to disgorgement; and
- Over time, the Respondent implemented remediation measures, including seeking proper approvals for itself and Registered Representatives, hiring a new carrying broker and creating proper books and records.

¶ 50 We viewed the following as mitigating factors:

- There is no evidence of client harm or client vulnerability;
- The Respondent has no disciplinary history; and
- The Respondent has implemented remediation measures including seeking the appropriate approvals for itself and its Registered Representatives.

¶ 51 We viewed the following as aggravating circumstances:

- The misconduct was extensive, and took place over an extended period of time;
- The Respondent engaged in unauthorized activity with retail clients after making representations to IIROC during its membership approval process that it did not intend to have retail clients. Further, once applying for IIROC approval of its retail business, it continued to conduct the retail business prior to obtaining approval.

¶ 52 In our view, the Settlement Agreement is consistent with the principles and the framework established by the Guidelines.

(iii) Previous Regulatory Decisions

¶ 53 In addition to considering the Guidelines, previous hearing panel decisions have, in determining whether the sanctions fall within a reasonable range of appropriateness, considered sanctions approved by hearing panels for similar types of misconduct. While it is rare to find cases with identical facts, it is of assistance to consider settlement decisions involving similar misconduct to assess, to the extent that they are comparable, whether the agreed sanctions fall within a reasonable range of appropriateness. However, it is important to keep in mind that each case must be considered on its own facts and circumstances.

¶ 54 CIRO staff referred us to a number of cases in support of the submission that the sanctions fell within a reasonable range of appropriateness.

¶ 55 In *Re Interactive Brokers Canada*[3], a settlement was entered into in which the respondent firm agreed to a number of contraventions: failing to maintain accurate books and records contrary to Dealer Member Rule 17.2 and 200; failing to accurately report financial information contrary to Dealer Member Rule 16.2; failing to report complete and accurate financial information contrary to Dealer Member Rule 16.2, 17.1, and 17.2; and failing to obtain proper evidence of its control over assets, contrary to Dealer Member Rule 29.1. A number of mitigating factors were considered including that the infractions were technical, unintentional, and committed due to incorrect interpretation of rules and not to bad faith, no client suffered any prejudice or was put at risk, and there

[3] 2009 IIROC 30 at paras 5-13.

was no capital deficiency. A fine of $40,000 was imposed for the four contraventions along with costs of $10,000.

¶ 56 In *Peak Securities Inc (Re)*[4], a settlement was entered into by which the respondent agreed that it had (a) breached Dealer Member Rule 38.1, by failing to establish and maintain a system that allowed adequate supervision over a period of approximately two years; and (b) breached Dealer Member Rules 38.1 and 2500, by failing to establish and maintain a system of internal controls over a period of approximately six years. The sanctions agreed to were a fine of $80,000 for failing to establish and maintain a system that allowed adequate supervision (Rule 38.1) and a fine of $50,000 for failing to establish and maintain a system of internal controls (Rules 38.1 and 2500), with costs of $5,000.

¶ 57 In *Re IPC Securities Corporation*[5] the hearing panel accepted a settlement that involved a number of clients who had made purchases relying on the accredited investor exemption when they clearly did not qualify under any of the provisions of the accredited investor definition. The respondent did not have any policies or procedures relating to ensuring that clients qualified as accredited investors. The respondent did not have adequate policies and procedures to deal with purchases of securities of private placements by retail clients, and failed to provide adequate training to its registered representatives and its compliance department, and lacked effective pre-trading and post-trading by retail clients in exempt distributions. The respondent admitted to contravention of Dealer Member Rule 38.1, Rule 1300.2 and Rule 2500 by failing to have established and maintained policies and procedures in order to supervise trading in client accounts. Mitigating factors were that there were no client complaints and no losses were claimed, and by the time of the settlement, the respondent had, as a result of the IIROC investigation, established more efficient policies and procedures to remedy its failings relating to the purchase of exempt securities. The agreed sanction was a fine of $65,000 with costs of $10,000.

¶ 58 In *Re Canaccord Genuity*[6] the hearing panel accepted a settlement by which the respondent agreed that it had, over a period of approximately nine years, breached Dealer Member Rules 38.1 and 2500 by failing to establish and maintain a system of internal controls and supervision reasonably designed to achieve compliance with IIROC requirements, including to deal fairly with clients with regard to fees. In particular, the respondent agreed that it had failed to have adequate internal systems and controls in place to detect and prevent instances where clients in fee-based accounts were also charged a trailer or embedded fee associated with an exchange traded fund or a structured product held in their accounts. Following an IIROC compliance review, the respondent updated its policies and procedures and made voluntary efforts to repay its current and former clients. The sanction was a fine of $157,500 with costs of $50,000.

¶ 59 In *Re Wells*[7], the hearing panel found that for a period of over two years, the respondent acted as an advisor, within the meaning of the Alberta *Securities Act*, without being registered, contrary to IIROC Dealer Member Rule 29.1. The respondent, although registered, did not have the appropriate portfolio manager designation or the training that was required to obtain the designation, and acted as an advisor to his employer's portfolio manager. The hearing panel noted a number of mitigating factors, including: that there was no harm to the respondent's clients or his employer; while the conduct was neither unintentional or negligent, it was not fraudulent or deceptive and he was transparent and fully cooperative with the regulatory authorities; there was a complete lack of vulnerability of the respondent's client. The respondent was fined $10,000 and ordered to pay costs of $13,000.

¶ 60 Not surprisingly, none of the cases referred to us by CIRO staff have facts that mirror all of the contraventions at issue here. However, each of the cases have some overlap with the Respondent's contraventions. It is apparent from a consideration of these previous decisions that the sanctions are within a reasonable range of appropriateness.

CONCLUSION

[4] 2020 IIROC 36, at paras 4-6.
[5] 2010 IIROC 24.
[6] 2021 IIROC 35.
[7] 2011 IIROC 15.

¶ 61 We found that the Settlement Agreement was within a reasonable range of appropriateness and approved it.

Dated at Toronto, Ontario this 18 day of July 2023.

Christopher Bredt, Chair

Colleen Wright

Tim Pryor

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

1. The Canadian Investment Regulatory Organization ("CIRO")[i] will issue a Notice of Application to announce a settlement hearing pursuant to sections 8215 and 8428 of the Investment Dealer and Partially Consolidated Rules (the "Investment Dealer Rules") to consider whether a hearing panel should accept this Settlement Agreement between Enforcement Staff and Red Cloud Securities Inc. (the "Respondent" or "Red Cloud").

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Enforcement Staff and the Respondent jointly recommend that the hearing panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement

OVERVIEW

4. Prior to January 30, 2020, Red Cloud was an Exempt Market Dealer regulated by the Ontario Securities Commission. As an Exempt Market Dealer, Red Cloud engaged in retail private placements.

5. On January 30, 2020, Red Cloud became a Dealer Member, limited to servicing institutional clients and was required to give up its registration as an Exempt Market Dealer.

6. On April 7, 2020, Red Cloud applied to IIROC to obtain approval to service retail investors. IIROC approved the servicing of retail investors on October 26, 2020.

7. In the period between January 30, 2020, and October 26, 2020, Red Cloud continued to service retail clients although not approved by IIROC to do so. In this period, Red Cloud did not have any representative registered with the required proficiencies to service retail clients.

8. Between January 30, 2020, and October 26, 2020, the Know-Your-Client ("KYC") documentation used by Red Cloud did not meet CIRO requirements.

9. Between February 2020 and August 2021, Red Cloud sold or facilitated the sale of private placements to approximately 192 different retail investors[8], but failed to establish and maintain a system of controls and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to prospectus exempt distributions, particularly the accredited investor exemption.

10. Further, Red Cloud conducted the private placement transactions off book, and did not, until August 2021, consistently open client accounts on Red Cloud's books, or obtain signed client account agreements, or

[8] Of the 192 investors, approximately 10 were Red Cloud employees and one related entity, Red Cloud Financial Services.

issue trade confirmations or monthly account statements, and, until August 2021, Red Cloud failed to maintain sufficient evidence of supervision or to have proper books and records to permit adequate supervision.

11. None of the clients engaged in the retail private placement transactions between February 2020 and August 2021 were harmed.

12. Since August 2021, Red Cloud has taken steps to remediate and rectify the contraventions as outlined below.

Red Cloud Becomes Dealer Member

13. By application dated August 16, 2019, Red Cloud applied for approval as an IIROC Dealer Member. Its application indicated a limited business line of corporate finance underwriting/sales, mergers and acquisitions/advisory and research, with its principal business devoted to institutional clients.

14. During the process of membership review, Red Cloud represented to IIROC that it did not intend to have retail clients but may consider having retail clients in eighteen to twenty-four months and would seek IIROC approval prior to such a change.

15. On January 30, 2020, IIROC approved Red Cloud as a Dealer Member.

16. Red Cloud's affiliate, Red Cloud Klondike Strike Inc., which had, since 2015, operated as an exempt market dealer in Ontario, surrendered its registration as an exempt market dealer effective January 30, 2020.

Red Cloud Approved for Retail

17. On or about April 7, 2020, Red Cloud applied for approval for retail trading and indicated that the trade activity would be limited to deals underwritten by Red Cloud.

18. On or about October 26, 2020, IIROC advised Red Cloud that it did not object to Red Cloud adding a new line of business for the distribution of securities to retail clients as an underwriter, part of an underwriting syndicate, or a selling agent for an underwritten transaction. IIROC also advised that its non-objection was subject to Red Cloud's proposed Registered Representatives meeting all retail proficiency requirements.

19. However, as set out below, prior to its approval for retail on October 26, 2020, Red Cloud had already engaged in approximately 25 private placements that involved purchases by retail clients.

Registration and Approval of Red Cloud's Employees

20. Until December 8, 2020, none of Red Cloud's employees were registered to deal with retail clients.

21. On or about December 8, 2020, two Red Cloud employees became registered as Registered Representative, Retail.

22. On or about January 2021, another three Red Cloud employees obtained IIROC registration and approval to deal with retail clients.

23. In or about August 2021, an additional employee obtained IIROC registration and approval to deal with retail clients.

Red Cloud Dealings with Retail Clients Prior to Approval

24. Starting in February 2020, Red Cloud engaged in private placements that involved subscriptions by retail clients, and, by August 2021, had engaged in approximately 77 such private placements.

25. Between February 2020 and August 2021, Red Cloud sold or facilitated the sale of private placements to approximately 192 retail investors.

Red Cloud Dealt with Retail Clients Prior to Approval for Retail

26. Prior to its approval for retail on October 26, 2020, Red Cloud had already engaged in approximately 25 private placements that involved purchases by retail clients and received fees in connection with these distributions of securities.

Red Cloud Dealt with Retail Clients Before Employees Registered for Retail

27. The 29 deals that occurred between February 2020 and December 8, 2020, occurred before any of Red Cloud's employees were registered or approved to deal with retail clients.

28. The 48 deals that occurred on or after December 8, 2020, occurred while some of Red Cloud's employees were registered and approved to deal with retail clients, but the Red Cloud employees with whom the clients dealt in respect of these deals were not registered and approved to deal with retail clients in all cases.

Red Cloud's Failure to Maintain Books and Records

29. In the 77 deals that occurred between February 2020 and August 2021, Red Cloud failed to adequately record the trading activity on its books and failed to otherwise maintain adequate books and records related to this activity.

30. On or about January 26, 2021, IIROC approved the bulk transfer of Red Cloud client accounts to Red Cloud's new carrying broker.

31. With its new carrying broker, Red Cloud then began a process of opening accounts for clients, with the first account statements being issued for the period February 2021.

32. Prior to transfer to the new carrying broker, Red Cloud failed to process any of the private placements on its books.

33. Even after February 2021, Red Cloud continued to sell securities to clients by way of private placements without, in some cases, opening client accounts or issuing trade confirmations or account statements. Red Cloud did so until August 2021.

Red Cloud's KYC Failures

34. Red Cloud did not update its KYC documentation when it became a Dealer Member on January 30, 2020. Consequently, the KYC documentation used by Red Cloud did not meet IIROC requirements.

35. Until about August 2021, Red Cloud failed to consistently collect client information in a manner consistent with its KYC obligations.

36. Further, as private placements, the deals in which Red Cloud engaged were not qualified by prospectus, and, therefore, only permitted to be distributed pursuant to prospectus exemptions.

37. From February 2020 to August 2021, Red Cloud sold securities to retail clients primarily pursuant to the accredited investor prospectus exemption in s. 2.3 of National Instrument 45-106 Prospectus and Registration Exemptions.

38. Prior to August 2021, Red Cloud's process to determine whether clients were able to rely on a valid prospectus exemption, such as the accredited investor exemption, was inadequate.

39. Red Cloud did not have an adequate process in place by which Red Cloud would check whether the client's KYC information matched the criteria indicated on the accredited investor forms to confirm whether the prospectus exemption was available to the client.

40. Further, Red Cloud failed to maintain sufficient evidence that it had reviewed the client's eligibility to claim accredited investor status.

Supervision Failures

41. Between January 2020 and February 2021, Red Cloud did not have Supervisors responsible for new

accounts openings, including the completion of new account forms, or subsequent account supervision.

42. Between June 30, 2020 and May 25, 2021, a series of different individuals were appointed to the role of Chief Compliance Officer and others were appointed as Supervisors, but there continued to be gaps in the supervision of the trades conducted by Red Cloud on behalf of retail clients.

43. Further, Red Cloud failed to maintain proper or adequate books and records by which Supervisors could properly review trading activity.

44. In particular, between February 2020 and August 2021, Red Cloud failed to establish and maintain a system of control and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to the accredited investor prospectus exemption.

Fees and Compensation

45. Between February 2020 and August 2021, Red Cloud received compensation (commissions and warrants) in connection with securities purchased by its retail clients by private placement while Red Cloud was not compliant with its regulatory obligations under IIROC rules, including the following:

    (a) Red Cloud received fees of $277,464.94 and warrants of 3,192,325 with a realized value of $79,352.46 for transactions prior to October 26, 2020, when the firm became licensed to deal with retail clients. The remaining warrants have either expired or are worthless;

    (b) Red Cloud received fees of $12,014.04 and warrants of 27,116 with a realized value of zero dollars, with the warrants expired worthless for transactions between October 26, 2020 and December 8, 2020, when the first Registered Representative ("RR") was approved to deal with retail clients; and

    (c) Red Cloud received fees and warrants for transactions between December 8, 2020 and August 2021 of which:

        (i) fees of $224,690.30 and 1,316,990 warrants with a realized value of $6,164.45 were for transactions where the client was not dealing with an RR registered for retail, including where the client was either a Red Cloud affiliate (no fees charged) or an employee of Red Cloud, and no Red Cloud account was opened for the client; and

        (ii) fees of $11,619.99 and 54,542 warrants with a realized value of zero dollars, with the warrants expired worthless were for transactions where the client was not dealing with an RR but a Red Cloud account was opened. Seven of these eight instances involved either a Red Cloud affiliate or one of Red Cloud's executive. The fees are in respect of transactions where the client was a Red Cloud Executive. Fees were not charged in connection with Red Cloud affiliates.

46. Red Cloud received fees of $100,106.41 and 483,008 warrants with a realized value of zero dollars, with the warrants expired worthless for all transactions between December 8, 2020 and August 2021 where the client dealt with an RR registered for retail and had a Red Cloud account.

PART IV – CONTRAVENTIONS

47. By engaging in the conduct described above, the Respondent committed the following contraventions of CIRO requirements:

    (a) Between February 2020 and August 2021, Red Cloud permitted persons to act on behalf of the Dealer Member without proper approval, contrary to Dealer Member Rule 18.2.

    (b) Between February 2020 and August 2021, Red Cloud failed to process all of its activity related to the sale of securities to retail clients through private placements on its books and records, contrary to Dealer Member Rules 17.2 and 200.2.

    (c) Between February 2020 and August 2021, Red Cloud failed to establish and maintain a system of

controls and supervision that was adequate to ensure that clients were qualified to purchase securities offered pursuant to prospectus exempt distributions, contrary to Dealer Member Rules 38.1, 1300.2, and 2500 (II).

PART V – TERMS OF SETTLEMENT

48. The Respondent agrees to the following sanctions and costs:

    (a) disgorgement in the amount of $611,306.18;

    (b) a fine in the amount of $100,000; and

    (c) costs in the amount of $15,000.

49. If this Settlement Agreement is accepted by the hearing panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Enforcement Staff and the Respondent.

PART VI – STAFF COMMITMENT

50. If the hearing panel accepts this Settlement Agreement, Enforcement Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.

51. If the hearing panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of this Settlement Agreement, Enforcement Staff may bring proceedings under Investment Dealer Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out in Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

52. This Settlement Agreement is conditional on acceptance by the hearing panel.

53. This Settlement Agreement shall be presented to a hearing panel at a settlement hearing in accordance with sections 8215 and 8428 of the Investment Dealer Rules, in addition to any other procedures that may be agreed upon between the parties.

54. Enforcement Staff and the Respondent agree that this Settlement Agreement will form all the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the hearing panel.

55. If the hearing panel accepts this Settlement Agreement, the Respondent agrees to waive all rights under the Rules of CIRO and any applicable legislation to any further hearing, appeal and review.

56. If the hearing panel rejects this Settlement Agreement, Enforcement Staff and the Respondent may enter into another settlement agreement or Enforcement Staff may proceed to a disciplinary hearing based on the same or related allegations.

57. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the hearing panel.

58. This Settlement Agreement will become available to the public upon its acceptance by the hearing panel and CIRO will post a copy of this Settlement Agreement on the CIRO website. CIRO will publish a notice and news release of the facts, contraventions, and the sanctions agreed upon in this Settlement Agreement and the hearing panel's written reasons for its decision to accept this Settlement Agreement.

59. If this Settlement Agreement is accepted, the Respondent agrees that neither they nor anyone on their behalf, will make a public statement inconsistent with this Settlement Agreement.

60. This Settlement Agreement is effective and binding upon the Respondent and Enforcement Staff as of the

date of its acceptance by the hearing panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

61. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.

62. An electronic copy of any signature will be treated as an original signature.

DATED this "21" day of "June", 2023.

RED CLOUD SECURITIES INC.

Per:

"Bob Sellars"

Witness

"Bruce Tatters"

Name: "Bruce Tatters"

Title: "CEO"

I have authority to bind the corporation.

"Sylvia Samuel"

Sylvia Samuel

Senior Enforcement Counsel on behalf of Enforcement Staff of the Canadian Investment Regulatory Organization

The Settlement Agreement is hereby accepted this "12" day of "July", 2023 by the following Hearing panel:

Per: "Chris Bredt"

Chair

Per: "Colleen Wright"

Industry Member

Per: "Tim Pryor"

Industry Member

[i] On January 1, 2023, IIROC and the MFDA were consolidated into a single self-regulatory organization recognized under applicable securities legislation.
The Canadian Investment Regulatory Organization ("CIRO") has adopted interim rules that incorporate the pre-amalgamation regulatory requirements contained in the rules and policies of IIROC and the by-law, rules and policies of the MFDA (the "Interim Rules"). The Interim Rules include (i) the Investment Dealer and Partially Consolidated Rules, (ii) the UMIR and (iii) the Mutual Fund Dealer Rules. These rules are largely based on the rules

of IIROC and the rules and certain by-laws and policies of the MFDA that were in force immediately prior to amalgamation. Where the rules of IIROC and the rules and by-laws and policies of the MFDA that were in force immediately prior to amalgamation have been incorporated into the Interim Rules, Enforcement Staff have referenced the relevant section of the Interim Rules.

Section 1105 (Transitional provision) of the Investment Dealer and Partially Consolidated Rules sets out CIRO's continuing jurisdiction, including that CIRO shall continue the regulation of any person subject to the jurisdiction of the Investment Industry Regulatory Organization of Canada that was formerly conducted by the Investment Industry Regulatory Organization of Canada.