

Legal Opinion Synopsis–
AurusGOLD Limited – AWX

Dated: 30 May 2019

Advice provided by: Oliver Woodhouse, Solicitor
Rachel Hillier, Senior Associate

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1. Executive Summary

Based on our assessment of the UK regulatory regime, and consideration given to European level instruments – MIFID and MIFIR; we do **not** consider AWX or AWG to be a Security Token. Accordingly, both tokens fall outside of the UK’s regulatory perimeter.

The characteristics of each token do not satisfy the legislative requirements of an FCA “Specified Investment” or a MIFID “Financial Instrument” and therefore Aurus’ own activities in relation to AWX and AWG do not amount to FCA “Regulated Activities” or MIFID “Investment Services / Activities”.

This means that AWX and AWG do **not** fall within the current regulatory perimeter and Aurus will **not** require FCA authorisation or permissions to launch the AWX token sale or to conduct its business model generally. This is important, as carrying on a Regulated Activity without appropriate permissions is a criminal offence in the UK².

We consider AWX and AWG each have characteristics of both Utility Tokens and Exchange Tokens (and AWG also a Stablecoin) – meaning each are a form of “hybrid” token. This is the most appropriate way to categorise each token, given the “roadmap” in the Aurus Business Plan includes broad goals for each.

We are confident of our assessment of the regulatory perimeter and our conclusions in context of AWX and AWG; however – we cannot predict changes in the regulatory treatment of Cryptoassets in the UK and globally. We suggest Aurus submits an application to the FCA Direct Support team. This will help facilitate further discussion on AWX, AWG and the Aurus project.

² Art. 20 and 23 of FSMA.

2. FCA Guidance & Terminology

a. Cryptoassets

This section of the Opinion provides an overview of the FCA guidance on Cryptoassets, to provide context to our assessment of AWX and AWG. Note that the FCA's guidance is not current law and is part of an ongoing consultation with the Cryptoassets industry. It does, however, give the FCA's current views on the classification and regulation of Cryptoassets, subject to the conclusion of the consultation (expected by the end of 2019).

CP19/3 and the Taskforce Report identify three types of Cryptoassets: *Exchange Tokens*; *Security Tokens*; and *Utility Tokens*.

Security Tokens

CP19/3 deems security tokens to have the following characteristics:

“those tokens that meet the definition of a Specified Investment as set out in the RAO, and possibly also a Financial Instrument under MIFID... these tokens have characteristics which mean they are the same as or akin to traditional instruments³”

“we consider a security to refer broadly to an instrument ... which indicates an ownership position in an entity, a creditor relationship with an entity, or other rights to ownership or profit. Security tokens are securities because they grant certain rights associated with traditional securities.... Security tokens are the type of Cryptoassets which falls within the regulatory perimeter⁴”

Exchange Tokens

CP19/3 deems exchange tokens to have the following characteristics:

“these are not issued or backed by any central authority and are intended and designed to be used as a means of exchange. They are, usually, a decentralised tool for buying and selling goods and services without traditional intermediaries. These tokens are usually outside the perimeter⁵”

CP19/3 also expressly examples the holding of an asset or commodity in the hope of a gain in value⁶ as being similar to holding an Exchange Token (noting this is unregulated), it continues to state that Exchange Tokens can be pegged to *“other forms of assets to stabilise their volatility”⁷*.

Utility Tokens

CP19/3 deems utility tokens to have the following characteristics:

“utility tokens provide consumers with access to a current or prospective service or product and often grants rights similar to pre-payment vouchers... utility tokens can usually be traded on a secondary market and be used for speculative investment purposes. This does not mean these tokens constitute Specified Investments⁸”

Stablecoins

A token may also be a “Stablecoin”. CP19/3 at Para. 4.12 describes Stablecoins as:

³ CP19/3, What are Security Tokens? – Para 3.43 – 3.44

⁴ CP19/3, What are Security Tokens? – Para 3.45 – 3.46

⁵ CP19/3, Para. 2.5 – Exchange Token

⁶ Which can be distinguished from holding for the provision of an income.

⁷ CP19/3, Para 3.36 – 3.37

⁸ CP19/3, What are Utility Tokens? – Para 3.51 – 3.52

*“tokens whose value – measured in a traditional fiat currency, like GBP or USD – does not fluctuate substantially. In order to achieve that, the value of stablecoins is pegged to ... fiat currencies, **other commodities or assets (e.g. gold and oil)**, a basket of other Cryptoassets (e.g. Bitcoin and Ether) or determined through sophisticated algorithms”.*

The Taskforce Report (published in October 2018) makes no reference to Stablecoins whatsoever, despite the report stating it:

“provides an overview of Cryptoassets and the underlying technology, assesses ... risks and potential benefits, and sets out the path forward with respect of regulation in the UK⁹”.

Based on this, and the somewhat limited comments on Stablecoins in CP19/3, we do not consider that the FCA has gone as far as to categorise Stablecoins as a fourth, standalone, category of token.

Our Opinion on the FCA’s “Token” terminology

The critical purpose of this legal opinion is to establish if AWX and/or AWG is a **Security Token**, meaning that it would fall within the FCA’s regulatory perimeter in the UK (either as a Specified Investment or a Financial Instrument under MIFID). The distinction between Exchange Tokens and Utility Tokens is secondary to this, because these tokens will, in isolation, more likely than not fall outside the FCA’s **current** regulatory perimeter.

We note that activities related to an Exchange Token or Utility Token *could* be brought within the FCA regulatory perimeter in certain circumstances i.e. if these activities amount to a Regulated Activity requiring FCA authorisation.

b. FCA Specified Investments & Regulated Activity

In the UK, a business must not carry on a Regulated Activity, or purport to do so, unless it is authorised by the FCA (or Prudential Regulatory Authority, if applicable) or is an exempt person¹⁰.

This is very important. It forms the underlying reason for the regulatory assessment of AWX / AWG, i.e. whether it is a Security Token falling within the FCA regulatory perimeter.

- A **“Regulated Activity”** is an activity listed in the RAO¹¹ that is carried on by way of business in relation to a Specified Investment. Regulated activities include, but are not limited to (i) Dealing in Investments as Principal/Agent; (ii) Arranging Deals in Investments; (iii) Accepting Deposits; (iv) Collective Investment Schemes.
- A **“Specified Investment”** is any of the investments (which may include any asset, right or interest¹²) listed in Part III of the RAO. This includes, but is not limited to: (i) shares; (ii) debt instruments; (iii) rights in relation to certain Specified Investments; (iv) derivatives.

c. European Financial Instruments & Investment Services and Activities

Broader European level legislation/directive; MIFID and MIFIR, must also be considered. This is needed as MIFID introduces broader interpretation of investments and additional activities, which now fall within the UK/FCA regulatory perimeter. MIFID does not have definitions of “Regulated Activity” and “Specified

⁹ Taskforce Report, Page 2 (Foreword)

¹⁰ S19 FSMA – the general prohibition

¹¹ See Part II of the RAO, which details a list of these specified activities.

¹² S22(4) FSMA

Investment; but has the broadly similar definitions of “**Investment Services & Activities**”¹³; and “**Financial Instruments**”¹⁴.

¹³ Set out in Section C, Annex I of MIFID

¹⁴ Set out in Section C, Annex I of MIFID, and analysed in Annex IV of this Opinion.

3. AWX

Proceeds of sale of AWX will be used by Aurus to develop the business. AWX will provide the holder with an income in the form of AWG, calculated as a proportion of fees derived from each AWG transaction – the AWG Temporary Reserve.

Rights attached to the AWX token derive from the AWX Smart Contract. These rights include the receipt of a percentage of the AWG Temporary Reserve. The AWG Temporary Reserve is controlled and distributed in accordance with the code/algorithm of the AWX Smart Contract, Aurus will not alter/change this – Aurus sees AWX as a tool to speculate on the AWG transaction volumes.

The proportion of the AWG Temporary Reserve that is payable to an individual holding an AWX token is immediately identifiable by the AWX Smart Contract, with the overall balance and allocation of the AWG Temporary Reserve being updated per AWG transaction.

In context, if an individual holds AWG and AWX in their wallet/s they will see the following balances:

1. AWX tokens in the AWX Smart Contract;
2. AWG tokens in the AWG Smart Contract; and
3. AWG tokens in the special collected fee balance of the AWX Smart Contract – the AWG Temporary Reserve.

Balances of **1.** and **2.** can be identified via a blockchain explorer – <https://etherscan.io>. The balance at **3.** requires a special “*call*” function to be made under the AWX Smart Contract. Accordingly, the AWG Temporary Reserve (and proportion due to an AWX holder) may look like a *yield* stored separately to an individual’s AWX tokens.

An AWX holder can redeem their proportion of the AWG Temporary Reserve, subject to certain parameters defined in the AWX Smart Contract (for example, a minimum sum of 0.5 AWG). Once called, the AWX Smart Contract will identify the AWG Temporary Reserve attributable to the AWX tokens and execute the transfer of AWG due to the AWX holder’s wallet. The AWX holder is responsible for paying the “Gas” fee owed to the Ethereum network.

AWX may be traded on secondary markets and exchanges. Rights to the AWG Temporary Reserve will also pass with ownership of the AWX token. The new AWX owner will have rights to further AWG income via the AWG Temporary Reserve.

Aurus is still developing solutions to avoid sums of AWG accumulating which may not be claimed, for example: due to death, or loss of access to a wallet/private key – these include: proof of “*life*” transfers and potential “*seizure*” of AWG Temporary Reserve proportions not claimed within a designated period. These finalised arrangements will need to be set out in any SAFT Agreement for AWX holders as part of the token sale.

Note – as outlined in **Part 1. (c)** – we have assumed that Aurus’ creation of AWX is separate to tokenisation of AWG.

a. AWX – Token Characteristics

i. AWX – Key Characteristics

- AWX is a pre-mined token created by Aurus. It will have a fixed supply of 30 million tokens. Unlike AWG, AWX is not backed by an asset/commodity;
- AWX will be sold to purchasers and will act as a fundraising mechanism for the Aurus business to develop and market its blockchain solution;

- AWX holders will receive a proportion of the AWG Temporary Reserve, in the form of AWG. These rights will be governed by the AWX Smart Contract, and provide a means of return or revenue stream to an individual holding the AWX token;
- Aurus see AWX as a tool which allows AWX holders to speculate on transaction volume of AWG;
- Aurus is “*tied*” to AWX, in that it created the token and will maintain ownership of AWX that is not distributed and sold on the open market/sold as part of the token sale. Aurus may open future rounds to sell this AWX;
- AWX is different to AWG, the creation process will not involve third parties i.e. Minting Partners and/or Vault Partners;
- AWX will operate using decentralised blockchain technology, it will be transferable to third parties (subject to any terms/requirements outlined in the SAFT) and transaction information will be publicly available.

ii. AWX – Analysis

This section of the legal opinion considers the characteristics of AWX and the AWX Smart Contract and draws on the Token definitions included at **Part 3.** above and the more detailed FCA / MIFID regulatory review at **Annex IV – Table (a)** and **Table (b).**

Is AWX a Security Token? – No

Following our review of the FCA regulatory perimeter and MIFID, we do **not** consider AWX is a Security Token.

We reach this conclusion following a substantial analysis of:

- Each RAO Specified Investment and the Financial Instruments set out in MIFID;
- Consideration of commentary and examples in CP19/3 and the Taskforce Report; and
- Commentary provided in the ESMA ICO Advice Note and ESMA Cryptoasset Survey.

Why is this the case?

FCA Specified Investments

AWX and the broader arrangement including the AWX Smart Contract and any SAFT (entered into by a buyer with Aurus) does **not** meet the criteria of any RAO Specified Investment; meaning Aurus’ activities will not amount to a Regulated Activity requiring FCA authorisation/permission to do business.

We summarise below our reasons why the AWX is not any one of the Specified Investments listed in the RAO. This summary should be read in conjunction with **Annex IV, Table (a)** which provides complete commentary and relevant statutory/legal references):

- **Deposits** – unlike a deposit, AWX will be sold to buyers and monies received by Aurus will not be repaid. AWX it is not a deposit;
- **Electronic Money** – e-money is a pre-paid product issued only on receipt of funds. Aurus will create AWX independent of receipt of monies from a buyer and hold AWX for resale in later rounds. Further, AWX is not “stored monetary value” operating as a “claim” against Aurus. AWX is not “e-money”.
- **Rights under a Contract of Insurance** – AWX grants a buyer the right to a percentage of the AWG Temporary Reserve; this does not operate akin to a “right” under a Contract of Insurance because there is no assumption or transfer of risk between Aurus and the buyer. Therefore, none of the AWX, the SAFT arrangement or the AWX Smart Contract will operate as this form of Specified Investment.

- **Shares etc.** – AWX will not represent a share, stock, voting right, ownership, equity or otherwise in Aurus’ own share capital, nor will any dividends derive from Aurus. AWX will be sold to a buyer, in exchange for a right to a percentage of the AWG Temporary Reserve. Therefore, AWX is not a “share”;
- **Debt Instruments** – AWX does not create or acknowledge a form of indebtedness between parties, nor will the monies paid to Aurus be returned to the buyer after a certain term/period – due to this we have not considered the intricacies of specific forms of Debt Instruments (for example: debentures, bonds, loan stock; or government and public securities); AWX is not a debt instrument;
- **Alternative Finance Investment Bonds (AFIBS)** – this can be discounted for reasons similar to those outlined in “*Debt Instruments*” above;
- **Warrant** – a warrant grants rights to the holder to subscribe in a share or certain debt instruments. AWX does not meet the criteria of these Specified Investments, therefore the SAFT cannot amount to a Warrant. The same applies to AWX in context of AWG and the AWG Temporary Reserve (we do not consider AWG to be a Specified Investment, please see **Part 5.** of the Opinion). This position also applies to the broader “warrant” definition relevant in context of rights in Collective Investment Schemes (this includes rights in relation to Transferable Securities – see **Annex IV, Table (b)** MIFID Financial Instruments), as the arrangement does not amount to a Collective Investment Scheme, or a Transferable Security.
- **Certificates Representing Securities** – this Specified Investment is different to a Warrant, it includes a certificate or instrument conferring rights over other Specified Investments¹⁵ (Shares, Debt Instruments, AFIBs and Warrants). AWX and the SAFT confers rights on the AWG Temporary Reserve, but the AWX Smart Contract and AWG do not satisfy criteria of Art. 76 – 79 – neither AWX, the SAFT or the AWX Smart Contract is a Certificate Representing Securities.
- **Units (in a Collective Investment Scheme (“CIS”))** – assessment of whether the arrangement amounts to a Collective Investment Scheme have required a higher level of consideration to the other Specified Investments; **Annex IV, Table (a)** should be reviewed for this commentary. Effectively, s. 235 of FSMA defines a Collective Investment Scheme as:
 - o “any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income”.
 - o “arrangements must be such that the persons who are to participate do not have day-to-day control over the management of the property, whether or not they have the right to be consulted or to give directions”; and
 - o “arrangements must also have either or both of the following characteristics –
 - The contributions of participants **and** the profits or income out of which payments are to be made to them are pooled;
 - The property is managed as a whole by or on behalf of the operator of the scheme”.

Application of the Collective Investment Scheme definition (we consider only part of the definition is satisfied):

- o the SAFT would act to document rights and interests of an AWX holder, as would the AWX Smart Contract;

¹⁵ RAO Art. 76 – 79

- the AWG Temporary Reserve could be considered the “*property*” for the purpose of a CIS to which profits/income derive, the SAFT outlining how the AWX token interacts with the AWX Smart Contract and AWG Temporary Reserve;
- following this, AWX could be considered a “*unit*” to allow a buyer to exercise rights; **however**, this will only amount to a Specified Investment i.e. “*unit*” if s.235 is satisfied;
- we consider satisfaction of the 2nd part of the definition is **not satisfied**:
 - an AWX holder has no control, voting rights or decision-making capabilities over Aurus management or operations, but an AWX holder will have a degree of control over the holding and management of the “*property*” (the AWG Temporary Reserve) and the AWX holder can “call” on the AWX Smart Contract, identify AWG due and transfer it;
 - the AWG Temporary Reserve is held on a pre-defined basis as set out in the AWX Smart Contract algorithm, and will only interact with the AWX tokens in this prescribed way, it will not alter. This demonstrates there is no active management by Aurus in relation to the AWG Temporary Reserve (this is considered in context of the 3rd part of the definition below);
 - AWG in the AWG Temporary Reserve will immediately be proportioned to specific AWX tokens on completion of a transaction on the AWG network; this demonstrates a further lack of management¹⁶;
- Either or both elements of the 3rd part of the definition need to be satisfied; the AWX / Aurus model **does not** achieve this:
 - “pooling” is **not** achieved. Contributions from a buyer and profits/income are not collectively pooled – buyers’ monies are paid direct to Aurus at the point of purchase of AWX tokens, not pooled with the AWG. Aurus will spend this for **commercial** purposes, not invest it on behalf of the AWX holder;
 - further, the “*property*” is not “managed as a whole” by Aurus as an operator:
 - the AWG Temporary Reserve will be governed by the AWX Smart Contract, and the parties agree to these terms by entering into the SAFT;
 - AWX holders can access their proportion of the AWG Temporary Reserve; and
 - Aurus cannot be considered to have responsibility for management as a whole given:
 - it cannot amend the agreed terms of the AWX Smart Contract;
 - Aurus is not able to “manage” the algorithm that allocates and accumulates the AWG in the AWX Temporary Reserve. This is governed by the AWG Smart Contract and the AWX Smart

¹⁶ FCA v Capital Alternatives Ltd and others [2015] EWCA Civ 284 further considers “management as a whole”, as to that it states the question to consider is “*was that there was collective management of Yoni Farm [i.e. the Investment] as one entity as opposed to management of the investors’ individual interests*”.

We content there is no management and even if there was to be it is not as a whole due to the proportioned nature of the AWX tokens entitlement to part of the AWG Temporary Reserve.

Contract and is entirely dependent on independent third parties trading AWG on the AWG network;

- Aurus has no control or discretion on *when* the AWG Temporary Reserve is distributed;
- additionally, if “*property*” were to be considered AWG, generally, Aurus still has no control of this and the physical gold is secured by the Vault Partners;
- Finally, we find it difficult to interpret how AWX can definitively be considered a “Unit” as the SAFT will be the document outlining specific rights and interests of the buyer – which will be provided to the buyer as part of any token sale. With this in mind, the AWX will be transferable and it is not anticipated that future SAFTs will be entered into between Aurus and the new AWX holder, if AWX holders exchange the token on a platform.
- In our view, this means that the arrangement cannot amount to a Collective Investment Scheme, and neither AWX or the SAFT can be considered a “Unit”.

Derivatives

- Options

- an Option is a right to acquire or dispose of certain assets, including gold and commodities in accordance with the terms of a contract (ordinarily at discretion of a party), this will run for a defined term or period; and
- AWX, the SAFT and AWX Smart Contract **do not** satisfy the criteria of this Specified Investment, revenue is derived from transaction fees on the AWG network, it is subject to transaction volume no value of an underlying asset, gold/AWG; and there is no timeframe/requirement for exercise of rights to acquire or dispose of the AWG.

- Futures

- A Future is a right under a contract for sale of a commodity or property, with delivery to be made at a future date at a price agreed between parties at the outset. A Future **expressly excludes** rights under any contract which is made for commercial purposes¹⁷.
- AWX and the SAFT arrangement will not amount to this Specified Investment; as the sale of AWX will be a commercial arrangement, as Aurus will create and supply the AWX to the purchaser – the sale of AWX is not for investment purposes, Aurus is not restricted on how monies received for the sale are used by the business nor is there to be any investment terms or relationship between Aurus and the buyer.

- Contract for Differences

- This Specified Investment is a contract for a difference in price, value or otherwise, the existence of the contract being to secure a profit or avoid a loss by reference to certain fluctuations.

¹⁷ Art. 84 (2) RAO.

- The RAO and MIFID require that Contracts for Differences must be cash-settled. Arrangements for the physical delivery of goods as settlement of a contract are expressly excluded¹⁸.
- AWX will fall outside of this as an AWX holder receives AWG, meaning this is not a cash-settled arrangement and therefore cannot be this Specified Investment. (**Note** – see **Annex IV, Table (b) C6** for the MIFID characteristics of Physical Settlement or Delivery).

The RAO does include certain other categories of Specified Investments; however these are significantly different to the arrangements intended by Aurus and do not require review¹⁹.

Based on the commentary above, and **Annex IV Table (a)** AWX will not amount to a Specified Investment.

MIFID Financial Instruments

AWX and the broader arrangement including the AWX Smart Contract and the SAFT **do not** meet the criteria of the Financial Instruments contained in MIFID. This consideration is important as certain MIFID Financial Instruments may be broader than FCA Specified Investments, and MIFID places additional requirements on firms providing Investment Services & Activities in context of Financial Instruments.

This section acts as a high-level precis of broader comments at **Annex IV, Table (b)** of the Opinion (which should be read in conjunction).

C1 – Transferable Securities

- AWX does not amount to a Transferable Security, in short, it does not meet the characteristics of Art. 4(1)(44) of MIFID, which defines a Transferable Security as:
 - “those classes of securities which are negotiable on the capital market, with the exemption of instruments of payment, **such as**:*
 - (a) *Shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;*
 - (b) *Bonds or other forms of securities debt;*
 - (c) *Any other securities giving the right to acquire or sell any such transferable securities or giving risk to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.*
- AWX does not satisfy the criteria for the instruments listed in (a) – (c) (effectively, these are those Specified Investments under the RAO considered above, albeit categorised as Financial Investments under MIFID);
- However, the drafting of Art. 4(1)(44) is not definitive, i.e. **such as**, rather than **which are** or **only include**, for example. This means it could capture any other “classes of securities which are negotiable on the capital market” not listed in (a) – (c).
- We do not consider AWX to fall within this broader interpretation²⁰ as:

¹⁸ Art. 85 (2) (a) RAO.

¹⁹ These are listed at Footnote **Error! Bookmark not defined.**

²⁰ FCA Glossary – “securities” - <https://www.handbook.fca.org.uk/handbook/glossary/G1061.html>.

- AWX is not a security, it does not meet the FCA glossary definition, it does not fall within the different Specified Investments or Financial Instruments considered in this Opinion, nor does it meet the more ordinary dictionary definition:

“a thing deposited or pledged as a guarantee of the fulfilment of an undertaking, or the repayment of a loan, to be forfeited in case of default”; or

“Often, securities: A certificate attesting credit, the ownership of stocks or bonds, or the right to ownership connected with tradable derivatives”²¹

- AWX does not fall within other Specified Investments of RAO not flagged in (a) – (c), or other Financial Instruments within MIFID, for example: a Unit in a Collective Investment Scheme;
- Although AWX may be traded or exchanged between parties like any other form of property; we content it is not required to take place on a capital market; nor does it;
- AWX is merely a form of property which has rights attached to provide the holder of the token with another form of property, depending on transaction volume of the distribution network of that second property; the fact it is a commodity is irrelevant due to the unregulated status of these assets, additionally, the arrangement involves physical settlement or receipt of property rather than cash-settlement.

C2 – Money Market Instruments – broadly speaking, these instruments are debt instruments – treasury bills, certificates of deposit and commercial papers. AWX does not represent a debt, so it does not satisfy the criteria of this Financial Instrument;

C3 – Units in a Collective Investment Undertaking

- This includes units in a Collective Investment Scheme (which is discounted earlier in this section) and Units or Shares in an Alternative Investment Fund (“AIF”); the AWX arrangement is **not** an AIF.
- Art. 4(1)(a) of the Alternative Investment Fund Managers Directive defines an AIF as a collective investment undertaking which: **(a)** *raises capital from investors, with a view to investing in accordance with a defined investment policy for the benefit of those investors;* and **(b)** *does not require authorisation pursuant to Art 5. Of the Undertakings for Collective Investments in Transferable Securities Directive (UCTIS).*
 - **(a)** can be discounted as AWX is purchased by a buyer direct from Aurus, there is no investment policy as it is a commercial arrangement; nor is Aurus obliged to use the monies for the benefit of the buyer;
 - **(b)** is not relevant as the UCTIS relates to investment in Transferable Securities – neither AWX or AWG is a Transferable Security.

MIFID Derivative Instruments (C4 – C10)

The FCA Specified Investment section above and **Annex IV, Table (a)** outlines why we consider AWX is not a derivative, the remaining MIFID Financial Instruments (C4 – C10) are further types of derivatives with specific characteristics. Effectively, as we consider AWX is not an Option, Future or a Contract for Differences, we are satisfied that the arrangement will not amount to any form of derivative consider in the C4-C10 definitions.

Annex IV, Table (b) of this Opinion provides specific commentary on each C4-C10 MIFID Financial Instrument, and we recommend this is reviewed in full.

²¹ Oxford English Dictionary – <https://en.oxforddictionaries.com/definition/security>

Review of Regulatory Case Examples

In considering AWX's categorisation we have reviewed case studies in CP19/3, the Taskforce Report, ESMA ICO Advice and ESMA Cryptoasset Survey.

No single use case included operates as AWX does – i.e. an arrangement whereby the buyer and holder of the token receives a “*revenue stream*” in the form of an underlying *asset*, which is not directly “invested” into using monies generated via a token sale and is not cash-settled²².

Instead, all case studies which form a “revenue” in-fact operate as a profit share of an underlying business or have rights akin to conventional shares i.e. voting rights, or act as a Unit in a Collective Investment Scheme or provide remuneration in the form of cash.

Accordingly, this reaffirms our view that AWX is not a Security Token and is not a Specified Investment (under the RAO) or Financial Instrument (under MIFID).

Specific Examples:

CP19/3 – Case Study 1, at Page 24

A token providing a share of company profits and voting rights. This is a Security Token as it is a “share”.

The Aurus model is different, as an AWX holder receives a % of fees of the AWG network, in the form of AWG. The holder has no rights, voting or otherwise, in Aurus.

CP19/3 – Case Study 5, at Page 27

A firm investing in fine art, using funds it receives and pools from investors, it then hires out the art for a fee, token holders receive a proportion of the monies generated through this rental. This is likely to be a Security Token, because it is a “Unit” in a Collective Investment Scheme.

This is different to the Aurus model, it involves “pooling” of investment monies and profit, and in the example token holders are remunerated in cash, not an asset (AWG). Further, the firm is investing directly in the underlying asset – the art (or “property” for the purpose of the Collective Investment Scheme); Aurus does not invest in the AWG, there is no “investment” arrangement to the Aurus / AWX / AWX buyer relationship – the right to AWG remuneration is separate to the purpose the purchase monies.

EMSA Cryptoasset Survey – Case Study 1 – FINOM – Page 23

A business provides integrated financial services and wishes to allow access to Cryptoassets to a range of users, it issues tokens which grant users: 1) a share of profit in the form of dividends, 2) management rights, 3) rights to company assets.

National Competent Authorities responding to the ESMA Cryptoasset Survey considered Case Study 1 to amount to Transferable Securities under MIFID, the majority considered it a Share. We agree with this view, however – this model is different to AWX and the Aurus model as:

- AWX does not provide a share of profits or dividends in the Aurus business;
- No management rights in Aurus are granted to AWX holders; and
- An AWX holder is granted rights in the AWG Temporary Reserve, however this is not Aurus' property, the physical gold backing the AWG is held by a Vault Holder and ownership rights to AWG in the AWG

²² We use the term “cash-settled” in context of something settled through payment of money/a currency, that is not otherwise “physically-settled”. Art. 5(7) of MIFID defines “*physical settlement*” (in context of commodities, but works as a helpful example) to include: “(a) *physical delivery*.... (b) *delivery of a document giving rights of an ownership nature to the relevant commodities*.... (c) *other methods of bringing about transfer of rights of an ownership nature in relation to the relevant quantity of goods without physically delivering them, including notification*...”.

Temporary Reserve would be allocated to the holder of the AWX token via the AWX Smart Contract;
and

- There is no “investment” by Aurus in the underlying AWG property.

These differences reaffirm that AWX is not a Specified Investment or Financial Instrument.

ESMA Cryptoasset Survey – Case Study 2 – Polybius Bank – Page 24

A business issues tokens to develop its banking infrastructure and services. The token comes with a right to receive 20% of distributable profit of a financial year. No voting rights are attached to the token.

National Competent Authorities responding to the ESMA Cryptoasset Survey considered Case Study 2 would amount to a Transferable Security, due to the existence of profit rights in a business without ownership or governance rights, so long as the Cryptoasset were to meet the other conditions to qualify as transferable securities.

This is different to the Aurus / AWX arrangement as: (a) it is cash-settled, (b) profit is related to the business that issued the tokens, effectively acting as some form of preference share. This is entirely distinguishable to the AWX remuneration via the AWG Temporary Reserve.

ESMA Cryptoasset Survey – other types of Financial Instruments

Part 4 of the ESMA Cryptoasset Survey gives commentary regarding other Financial Instruments. On review, it appears all National Competent Authorities did not consider Case Study 1 or 2 to amount to:

- A Money Market Instrument;
- Units in a Collective Investment Undertaking; or
- A form of C4 – C10 derivative under MIFID.

This is important as Case Study 1 and 2 are “closest” to Aurus’ proposals for AWX (albeit with some key differences), which helps to conclude AWX is not one of these forms of Financial Instruments.

Is Aurus carrying on a Regulated Activity or Investment Service/Activity requiring FCA authorisation?

For the reasons set out above, AWX cannot presently be a Security Token – it does not meet the characteristics of a Specified Investment or a Financial Instrument based on the UK’s regulatory perimeter.

The benefit to this is that:

- AWX is not a Specified Investment or Financial Instrument;
- Aurus will not require FCA permission to carry on Regulated Activities, as even if it is to carry on an activity specified in the RAO it is not carried for business in relation to a Specified Investment²³.

Please note if the regulatory perimeter were to change, and AWX was subsequently deemed a Specified Investment or Financial Instrument – Aurus may require FCA permission to carry on its activities *if* these activities amount to a specified kind under FSMA/RAO (or a Investment Service or Activity under MIFID). This would be entirely dependent on the activities carried on at the point in time that any change to the regulatory perimeter occurred.

²³ Art. 19; Art. 22 FSMA.

In context, if AWX **were** a Security Token at some point in the future, we consider Aurus **may** require FCA permission in relation to the AWX token sale to carry on certain kinds of specified activities²⁴, including:

- **Dealing in Investments as Principal**²⁵, i.e. the selling of a Security Token; depending on the Financial Instrument / Specified Investment categorisation of the Security Token as certain are exempt;
- **Arranging Deals in Investments**²⁶, i.e. making arrangements with a person to buy, sell, subscribe for ... a particular investment which is a security or contractually based investment, for example; or making arrangements with a view to a person participating in the buying, selling or subscribing to an investment; although arrangements not causing a deal are excluded;
- **Managing Investments**²⁷ - if AWX was subsequently deemed a Security Token, and Aurus were to be considered as involved in management of the AWX via the AWX Smart Contract.

We have not considered this in detail, as it is not currently applicable to Aurus based on our conclusion of AWX.

Is AWX a Security Token – Conclusion - No

For the reasons set out above, we consider AWX cannot be a Security Token as it does not meet the characteristics of a Specified Investment or a Financial Instrument based on the UK's regulatory perimeter.

AWX – Other Token Characteristics

AWX is not a Security Token, instead we consider it to be a “hybrid” class of token, evidencing features of both Exchange Tokens and Utility Tokens (interpret in line with definitions provided in CP19/3 and Taskforce Report); green shading denotes similarity to that form of token, red denotes differences.

Exchange Token Characteristics	Utility Token Characteristics
AWX's centralised issuing distinguishes from exchange tokens.	AWX is created and issued by a single centralised party in the first instance – Aurus, i.e. the token sale.
During its lifetime, AWX may be traded or used as a means of exchange (following the token sale), as it will have an intrinsic value.	Aurus will sell AWX via a token sale. It will work as a tool to raise monies for Aurus but provide rights distinct from the Aurus business i.e. ownerships, equity, profit share of the <i>company</i> .
Trade of AWX could take place P2P, without the need for conventional intermediaries.	AWX may be held by firms and consumers wishing to “invest” in Cryptoassets, albeit executively.
AWX is not restricted to a closed network for use, for example: a specified online/digital platform.	AWX grants the holder to a current or prospective service or right, namely entitlement via the AWX to a proportion of the AWG Temporary Reserve.

²⁴ Subject to any available exemptions, although consideration of these fall outside the scope of this Opinion.

²⁵ Art. 14 RAO.

²⁶ Art. 25 RAO.

²⁷ Art. 37 RAO.

Exchange tokens may be “pegged”, “backed”, or linked to other Cryptoassets, which could help with volatility, for example.	These same rights do not, in our view, amount to those granted by a type of Specified Investment or Financial Instrument – which clearly distinguishes from the requirements of a Security Token.
Although not necessarily required for an exchange token, AWX is not mined, or acquired through similar activities.	AWX will not be restricted to ownership/use in a closed platform or environment, albeit the exercise of rights to the AWG Temporary Reserve will depend on the AWX Smart Contract.

AWX – Conclusion

As AWX is not categorised as a Security Token, we content that it is in fact a “hybrid” token – operating initially with the characteristics of a form of Utility Token; but subsequently having the capability to be used as a means of exchange following the initial token sale, hence it will later have features similar to an Exchange Token.

A token sharing characteristic in this way is very commonplace, particularly given the regulatory regime and generally global awareness of Cryptoassets is continuing to develop.

Further, we consider this conclusion best examples why the critical point of consideration was whether AWX was in fact a Security Token; with characteristics of an Exchange Token or Utility Token being secondary.

4. The 5th Anti-Money Laundering Directive & AML Regulation

The 5th MLD was announced by the European Parliament on 19 April 2018, the UK intend to transpose this into National Law by 10 January 2020. It amends the 4th MLD and, amongst other things, brings Cryptoassets into the scope (defined as “Virtual Currencies³⁷”) requiring business to carry out AML checks, undertake due diligence to identify customers and report suspicious transactions.

The 5th MLD focuses solely on direct regulation of: (1) *providers engaged in exchange services between virtual currencies and fiat currencies*; and (2) *Custodian Wallet Providers*³⁸ only.

The UK 5th MLD Consultation

HM Treasury³⁹ published the UK 5th MLD Consultation Paper in April 2019. It considers that all *relevant* activity involving Security Tokens, Exchange Tokens and Utility Tokens should be captured by AML and Counter-Terrorist Financing (“CTF”) regulation.

HM Treasury’s cites an increase in identified cases of Cryptoassets used to launder illicit proceeds as the reasoning for this and considers Cryptoassets pose the greatest threat from an illicit finance perspective at the point of exchange as this is the point of value-realisation.

Further, the Consultation acknowledges that some exchanges and wallet providers will fall outside of the 5th MLD if directly transposed and will not be required within the regulations to identify their customers, monitor transactions or report suspicious activity, making anonymous transactions possible.

HM Treasury proposes the UK should “gold plate” the 5th MLD; so all *relevant* activity in the UK includes:

- Crypto-to-crypto exchange services providers, including firms offering services allowing value transactions within a single Cryptoasset;
- Peer-to-peer exchange service providers, namely firms that facilitate exchange of fiat and Cryptoassets between prospective buyers and sellers;
- Cryptoasset ATM machines, in which users can directly exchange Cryptoassets for fiat;
- ICOs, token sales and other mechanisms for issuance of new Cryptoassets – STOs, IEOs etc.; and
- Publication of open-source software, which includes, but is not limited to, non-custodian wallet software and other Cryptoasset software.

FATF

The UK’s “gold plating” is no surprise, it is a member of FATF – the Financial Action Task Force on Money Laundering, an intergovernmental organisation comprising of c. 36 member jurisdictions representing many the world’s key financial centres.

³⁷ Art. 1(2)(d) 5th MLD defines “Virtual Currencies” as: “*a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically*”

³⁸ See Art. 1 (1)© 5th MLD regarding exchange services; and Art. 1 (2)(d) 5th MLD defines “Custodian Wallet Providers” as “*an entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer virtual currencies*”.

³⁹ HM Treasury forms part of the UK’s Cryptoasset Task Force, responsible for the Taskforce Report.

FAFT, in October 2018, updated its own glossary to provide a broader definition of “Virtual Currencies” than the 5th MLD, instead using the phrase “Virtual Asset⁴⁰”.

In February 2019, FAFT updated its binding Interpretive Notes, to provide clarification in relation to “Virtual Assets”⁴¹:

- *“for the purposes of applying the FATF Recommendations, countries should consider virtual assets as “property”, “proceeds”, “funds”, “funds or other assets”, or other “corresponding value”. Countries should apply the relevant measures under the FATF Recommendations to Virtual Assets and Virtual Asset Service Providers (“VASPs”;* and
- VASPs should be required to be licenced or registered in the jurisdiction they are created, and should be supervised/monitored by a competent authority (for example: the FCA in the UK), rather than self-regulation.

FAFT considers jurisdictions should apply a risk-based approach to ensure measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified; and suggests countries should require VASPs to identify, assess and take effective action to mitigate their money laundering and terrorist financing risks.

⁴⁰ FATF Glossary; “Virtual Asset” defined as: *“a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes”*. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets already covered elsewhere in FATF Recommendations.

⁴¹ FAFT Recommendation 15, Interpretive note, Para. 1 & 2.

<https://www.fatf-gafi.org/publications/fatfrecommendations/documents/regulation-virtual-assets-interpretive-note.html>

Annex I

<u>Definition & Glossary</u>	
Term	Defined
5th MLD Consultation Paper	The HM Treasury consultation of the 5 th MLD, published in April 2019.
Aurus	AurusGOLD Limited
5th MLD	The Fifth Money Laundering Directive (EU Directive 2018/843)
Aurus Business Plan	The Aurus Business Plan dated November 2018.
AWG	Aurus Gold, a 100% gold-backed Cryptoasset built on the Ethereum network.
AWG Temporary Reserve	A proportion of the AWG transaction fee charged per AWG transaction, calculated in accordance with the AWG Smart Contract, and collected / distributed to AWX tokens in accordance with the AWX Smart Contract.
AWG Smart Contract	For the purpose of this Opinion, the elements of the Smart Contract/s for the Ethereum blockchain/AWG network, used to calculate fees for each AWG transaction, proportion these fees according to certain parameters and direct the percentage for the AWG Temporary Reserve to the AWX Smart Contract.
AWX	Aurus Coin, a revenue sharing coin entitling holders to a proportion of AWG Temporary Reserve calculated in accordance with the AWX Smart Contract.
AWX Smart Contract	For the purpose of this Opinion, the element of the Smart Contract/s for the AWX blockchain/network: (1) responsible for the allocating of the AWG Temporary Reserve to AWX tokens, and (2) allowing AWX holders to “call” on the AWG Temporary Reserve to confirm the proportion of AWG due to the specified AWX tokens held.
CP19/3	FCA Guidance on Cryptoassets, Consultation Paper CP19/3 dated January 2019
EMR	Electronic Money Regulations 2011
ESMA ICO Advice	The European Securities & Markets Authority (“ ESMA ”) publication titled: ESMA – Advice on Initial Coin Offerings & Cryptoassets dated 9 January 2019.
ESMA Cryptoasset Survey	The ESMA publication titled: ESMA – Legal Qualification of Cryptoassets – Survey to National Competent Authorities dated 9 January 2019 (Annex 1 of ESMA ICO Advice).
FATF	The Financial Action Task Force on Money Laundering (an intergovernmental organisation comprising of c. 36 jurisdictions, representing the majority of the world's key financial centres (including the UK)).

FCA	Financial Conduct Authority
Financial Instrument	An investment defined in Annex I, Section C of MIFID, requiring regulatory authorisation if related to an Investment Activity.
FPO	Financial Services & Markets Act 2000 (Financial Promotion) Order 2005
FSMA	Financial Services & Markets Act 2000
ICO	Initial Coin Offering
Investment Activity	An activity specified in Annex I, Section C of MIFID, which requires regulatory authorisation when carried on in relation to a Financial Instrument.
MIFID	Markets in Financial Instruments Directive (2014/65/EU)
MIFIR	Market in Financial Instrument Regulation (EU No. 600/2014)
Minting Partners	Aurus-verified partners forming part of the AWG network, engaged for the purpose of creating (i.e. minting or tokenising) AWG linked to physical gold securely held by Vault Partners.
PERG	FCA Perimeter Guidance Manual
RAO	Financial Services & Markets Act 2000 (Regulated Activities) Order 2001
Regulated Activity	A regulated activity, broadly, is an activity carried out in respect of a Specified Investment in the RAO, by way of business.
Specified Investment	A type of investment which is specified in the RAO.
Taskforce Report	The UK Cryptoasset Taskforce: Final Report dated October 2018, prepared by HM Treasury, FCA and the Bank of England
Vault Partners	Aurus-verified partners forming part of the AWG network, engaged for the purpose of securely storing physical gold within the AWG network and recorded on the Ethereum blockchain; Vault Partners working alongside Minting Partners to distribute AWG.

Annex I

<u>Key Source List</u>	
5th MLD	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843
5th MLD Consultation Paper	https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/795670/20190415_Consultation_on_the_Transposition_of_5MLD_web.pdf
CP19/3	https://www.fca.org.uk/publication/consultation/cp19-03.pdf
ESMA ICO Advice	https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf
ESMA Cryptoasset Survey	https://www.esma.europa.eu/sites/default/files/library/esma50-157-1384_annex.pdf
Taskforce Report	https://www.fca.org.uk/news/news-stories/cryptoasset-taskforce-publishes-report-uk-approach-cryptoassets
FCA Glossary	https://www.handbook.fca.org.uk/handbook/glossary/
FPO	http://www.legislation.gov.uk/uksi/2005/1529/contents/made
FSMA	https://www.legislation.gov.uk/ukpga/2000/8/contents
MIFID	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065
MIFIR	https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=EN
PERG	https://www.handbook.fca.org.uk/handbook/PERG.pdf
RAO	http://www.legislation.gov.uk/uksi/2001/544/contents/made
UKJT Consultation Paper	UK Jurisdiction Taskforce Consultation Paper, published May 2019 – Cryptoassets, DLT and Smart Contracts https://www.lawsociety.org.uk/news/stories/cryptoassets-dlt-and-smart-contracts-ukjt-consultation/

Annex III - AWX Flowchart

