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## Ready for Boarding – How to Go Digital in the Fund Investor Admission Process

With a new investor's commitment to subscribe to a certain investment amount, much has been achieved for the fund manager. This also holds true if the commitment is only made by e-mail, text message or handshake – as a general rule, the fund manager should be able to rely on the added commitment. From a legal perspective, however, the process of enrolling the investor – known as onboarding – is only just beginning. The investor's qualification for the fund must be checked, due diligence obligations under money laundering laws must be fulfilled, and information has to be collected from the investor that may have regulatory or tax implications for the fund.

If the fund manager can offer investors an easy, state-of-the-art onboarding – compared to one that costs a disproportionate amount of work – then onboarding contains just as much of a competitive and thus fundraising factor as the convincing pitch deck or Private Placement Memorandum (PPM).

While striving to make the onboarding process as easy as possible for the investor, various legal regulations must be observed at the same time. Adherence to all legal requirements – i.e. „compliance“ – has long ceased to be a matter that would merely end up sitting in a drawer. Regulatory authorities and auditors monitor compliance very intensively, for example with regard to investor qualification or money laundering obligations. An onboarding process that facilitates the collection of complete and correct information and helps eliminate errors at the time of entry thus benefits the fund manager at least as much as the investor.

Today's onboarding is measured by its legal conformity and investor friendliness. How to best combine these two criteria is outlined in the following.



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## Requirements of stakeholders

### ■ Simplicity, clarity, less effort for all parties involved

Consider the heterogeneous mix of investors in private equity and venture capital funds. At one end of the scale, there are large institutional investors for whom investing is a daily business. Then there are investors with investment experience who invest through companies in a wide variety of domestic and foreign legal forms. And finally, at the other end of the scale, there is the first-time investor, who directly invests as an individual. However, they all have one thing in common: the need for simple, straightforward processes that involve as little effort as possible.

### ■ Distinct procedures and responsibilities

A clear process requires that investors know their contact person at every step of the process and that responsibilities are clearly assigned. In this regard, there is an alignment of interests with the fund manager, whom onboarding should not unnecessarily distract from the “actual” fundraising and investing.

### ■ Leveraging digital potential: interfaces, automation, portability and reusability of data

For quite some time, there was a lot of room for improvement with regard to onboarding processes. Many investors shared (and still share) their information with the fund manager by filling out long PDF documents that helped leading the investor through the questions only to a very limited degree. However, the venture capital and private equity market has meanwhile come to realize that the need for a streamlined, straightforward process is best realized digitally. Various solutions for digital onboarding are offered worldwide. Technological interfaces, automation, and the portability and thus “reusability” of data can save effort for all involved. Any data entered once by the investor can be digitally cross-checked



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more easily by the fund manager with other databases and migrated to other systems, or transferred by the investor to the subscription of other funds. Transfer errors are avoided and all parties benefit from increased efficiency.

### ■ **One-stop process integration: fundraising/data room, onboarding, communication and reporting**

The next step is to establish a technical link of the onboarding process with the other communication steps between fund managers and investors over the entire lifespan of a fund (data room in fundraising, notifications, reporting, passing of resolutions). Ideally, all steps should be handled by a single system. This simplifies data collection and processing and increases user-friendliness for investors. However, such deep integration in a single online platform also entails the risk of lock-in: it becomes difficult to switch to another provider or to transfer individual sections and functions to a less expensive or more functional platform. Weaknesses of a system have to be tolerated at the price of better functionality in other areas. It therefore seems more reasonable from the fund managers' point of view to pay attention to the connectivity of a platform in order to always be able to use the best solution for their own needs. This particularly applies to the aspect of a platform's compliance with the legal requirements that apply specifically to the fund manager.

### **Legal primacy**

#### ■ **General information of investors, AML verification, investor qualification, tax information, commercial register entry**

It is quite obvious that compliance with applicable laws must be ensured in the onboarding process, even if this may conflict with the desire to maximize investor satisfaction. It is therefore important for investors and fund managers alike to understand that all information requests in the onboarding stem from a legal ob-

ligation on the part of the fund manager. For example, onboarding processes of private equity and venture capital funds worldwide can be regrouped under the following areas of law: anti-money laundering, regulatory, tax and corporate law.

While in practice the necessity for basic information such as name, address and bank account is understandable to every investor, the effort required for the examination under anti-money laundering laws is often met with irritation if the legal background is unknown, as it is often the case for non-European investors.

German **anti-money laundering law** is based on the European Anti-Money Laundering Directives, so that comparable requirements apply at least within the EU. Fund managers are so-called obligated parties under the German Anti-Money Laundering Act (*GwG*). Accordingly, the fund manager must identify the investor, the persons acting on behalf of the investor and also all beneficial owners of the investor (§§ 10, 11 *GwG*). In this context, identification does not merely mean the naming of a person, but identification through the collection and verification of data. In principle, this requires the personal presentation and verification of an identification document on site. However, this method is obviously not suitable for digital onboarding. In addition, there are digital options for identification by video – more on this later – but these have not been implemented in a completely uniform manner throughout the EU. In addition, the German Federal Financial Supervisory Authority (*BaFin*) has published some very precise requirements that must be observed.

**Regulatory law**, which accompanies virtually all activities of the fund manager, also plays a central role in the onboarding process. Depending on the type of fund, investors must be classified as so-called professional or semi-professional investors. In some cases, this is subject to very strict information and formal requirements, such as the written form requirement for investor disclosures pursuant to § 1 (19) no. 33 lit. a) bb) of the German Investment Code (*KAGB*).

Moreover, the fund manager is required to collect **tax characteristics** from investors in order to comply with national and international tax reporting requirements and to be able to estimate repercussions on the deductibility of interest. The reporting obligations serve primarily to avert tax avoidance in cross-border

situations (reporting obligations under § 138b of the German Fiscal Code, FATCA and CRS reporting obligations under the German Financial Account Information Exchange Act).

Finally, there is a uniquely German feature that stands out in an international comparison: In classic fund entities in the form of limited partnerships, there is an obligation for investors to be entered in the **commercial register**, which requires notarial certification. Investors must be entered in the commercial register as limited partners and must henceforth take part in every following alteration of the fund's commercial register entry. For this purpose, the investor typically issues a notarized commercial register power-of-attorney to the fund manager in the onboarding process, so that investors do not have to be involved in any further entries during the lifetime of the fund. Compared to the other aspects mentioned, the notarized commercial register power-of-attorney is still the least digitized part of the onboarding process. Although solutions are also implemented in the area of small, merely registered fund managers in which investors participate through a fiduciary limited partner, a ban on the use of fiduciaries applies in the institutional area in accordance with § 127 (1) and § 152 (1) of the German Investment Code (*KAGB*) at the very latest when a full license is obtained.

### **Digital onboarding of investors – Which factors are important?**

In order to obtain the legally required information in the most investor-friendly way possible, legal efforts are being made to fully digitize the onboarding process. Three key legal issues are currently undergoing change: digital identification in accordance with the Anti-Money Laundering Act, the qualified electronic signature (QES) as a substitute for written form, and digital procedures regarding the commercial register.

#### **■ Digital AML identification solutions**

The German Anti-Money Laundering Act provides an exhaustive list of procedures that can be used to identify a natural person, of which the following procedures are likely to be relevant in the area of fund investments:

- ▶ Identification among persons physically present (including an equivalent video identification);
- ▶ Identification using electronic proof of identity; and
- ▶ Use of a qualified electronic signature (QES) in conjunction with a wire transfer of reference.

Identification may also be performed by a third party using the permitted procedures if this third party is itself an obligated party within the meaning of the Anti-Money Laundering Act (e.g. notaries and lawyers), or if the third party is qualified and contractually authorized.

In practice, digital onboarding processes within Germany can be implemented quite well with these procedures. But individual procedures are already unsuitable for identification processes within the EU. For example, there is currently no uniform solution for reading electronic proof of identity throughout the EU. Depending on the country of origin of the person to be identified, different providers would have to be integrated within a platform for the technical reading and verification of the electronic proof of identity. This procedure proves entirely unsuccessful for investors outside the EU, which are common in the private equity and venture capital sector. There is hope for the future in the fact that the EU requirements are to be harmonized further and international efforts to create a globally valid e-identity should be put into practice in a few years' time.

The use of a qualified electronic signature also only appears to be a readily implementable solution, as German law still requires a wire transfer of reference ("1-cent transfer") for this procedure so that personal details can be matched as part of the transfer. Particularly in the case of institutional investors, however, it will not be feasible for subscribers to initiate such a withdrawal from their private account.

In the meantime, video identification will therefore play a central role in the initial identification of investors and the individuals acting on their behalf in accordance with *BaFin* requirements. This procedure can currently be used to identify persons by means of an ID card or passport in most countries.

### ■ Written form

Another uniquely German requirement hinders the digitization of onboarding in the area of semi-professional investors, who represent a relevant investor group in the area of private equity and venture capital funds. In order to qualify as a semi-professional investor, the required experience and competence must be declared in writing. This legal written form is to be understood as a hand-written signature under the relevant declaration on paper.

However, the written form can be replaced by a QES, §§ 126 (3), 126a BGB. In practice, this requirement can therefore be reproduced digitally if the investor has a corresponding QES or a QES can be set up for the investor as part of the onboarding process.

In the future, there could also be simplifications to the statutory written form in general. At the time of writing, the German government is planning to strengthen the electronic form as part of a law to reduce bureaucracy.

### ■ Digital procedures regarding the commercial register

The commercial register process has been the most difficult step in the onboarding process to digitize, as it typically still requires a personal appearance at a notary's office. However, both the German commercial register and the notarial procedures required are themselves currently undergoing digitization processes. In the EU, these are largely driven by the Digitalization Directives.

Whereas in some other EU member states all notarizations can be issued in online form due to the latest European Digitalization Directive, the German implementation is somewhat more restrictive. The possibility of using online notarization procedures has only been introduced for selected certifications, § 40a (1) sentence 2 of the German Notarization Act. Despite expansion of the catalog in 2023, the certification of a commercial register power-of-attorney is not (yet) one of these, while the certification of the actual application to the commercial register is possible in the online procedure of the German Federal Chamber of Notaries, § 12 (1) of the German Commercial Code. The reason for

the exception of power-of-attorney is the fact that the legal effect of the power-of-attorney is attached to the original, for which no equivalent exists in the case of digital generation.

In practice, fund managers should therefore currently consider the following if they want to provide their onboarding in the most digital form possible: Many foreign investors perceive the notarial certification (and, if necessary, the additional certification, the so-called apostille) as an additional hurdle in the German onboarding process. Fund managers can point out to these investors, especially those from other EU member states, that certification in the investor's country may be obtainable online. For those investors in whose country of residence there is no digital option for this, consideration should be given to whether certification can be obtained online via the notarial procedure of another country. However, the following restrictions must be taken into account: language barriers, requirement of an apostille, possibility of issuing proof of representation, and technical framework conditions for online identification. The latter, like the online AML identifications (see above), could be decisive for cross-border matters in the long term.

Identification in German online notarial procedures works with the help of technical reading the ID document, which in fact currently limits its use significantly. It is true that ID documents from 14 other EU member states and the eID card or Union citizen card can be used. The latter is a chip card that can be applied for in Germany by EU or EEA citizens. In addition, only newer ID cards that have a machine-readable image of the holder are suitable. In the case of older ID cards, a passport is additionally required for identification in the online notarial process. Thus, the German online notarial process is a welcome step toward digitization. But in practice, it is probably more something for enthusiasts and unfortunately not yet anything for the average, often international, investor in a German private equity or venture capital fund.

As a substitute for the German online notarial procedure, solutions from our neighboring country Austria come into consideration. Here, there is no language barrier and no apostille is required for a certified commercial register power-of-attorney (Germany recognizes Austrian notarial deeds on the basis



of a bilateral agreement). Identification in Austrian online notarial procedures can also take place via video and is thus clearly more accessible internationally, provided that the provider of the video identification procedure can sufficiently check the identity documents for security features. It is precisely this easier method of identification that appears to restrict the use of Austrian online deeds in Germany: German notaries currently disagree whether certifications by video identification that do not meet the requirements of the German online notarial procedure (see above) are to be recognized due to the supposedly lower standard. This is surprising, as the procedures share the same European legal basis. So, although *BaFin* allows video identifications to suffice for AML onboarding reasons, video identifications for a commercial register power-of-attorney could still fail in practice.

### **Selection of a platform**

The optimal onboarding platform offers a high level of functionality, where the investor can click through the necessary information intuitively and in a short time without the need of further assistance, and as little evidence as possible has to be provided by the investor. An additional highlight can be a platform that offers (external) identification solutions or even links to commercial register procedures. At the same time, legal assurance for the fund manager and the investor must be guaranteed in the same way as if every piece of information were obtained and confirmed on paper. It is also no longer a side issue that onboarding platforms must comply with data protection requirements and offer high IT security for sensitive data. Finally, from the point of view of the fund manager and the investor, it must ideally be able to communicate with other platforms to enable the exchangeability of data and avoid a lock-in effect.

### **Resumé**

In light of the fact that an onboarding process involves the subscription to at least a six-figure, often a seven- or eight-figure sum over several years, legal security, data protection and IT security must take precedence over ease of use

and functionality in case there are conflicts of objectives between these requirements. However, current legal developments in the area of digitization raise hopes that there will be fewer conflicts between these goals in the future.

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