



First precedent: an offsetting sale prior to correction of an erroneous trade is not naked short selling

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- Case Resulting in Exemption from Administrative Penalties Based on the “Entitled Quantity” Doctrine

Shin & Kim LLC represented Company A, a Korean financial investment company, in a matter concerning whether an offsetting sale of shares executed before the filing of a correction request for an erroneous trade constituted naked short selling. The Securities and Futures Commission (“SFC”) determined that the transaction did not constitute naked short selling.

Notably, this was the first case in which an offsetting sale executed prior to a correction request for an erroneous trade had been flagged as potential naked short selling. The case may therefore be regarded as a leading precedent providing important guidance for determining whether similar transactions constitute naked short selling.

1. Key Issue: Does Detection by the Naked Short Selling Detection System (“NSDS”) Alone Establish Naked Short Selling?

In the instant case, Company A agreed with its client to take over the shares that had been traded as a result of Company A’s erroneous order and subsequently executed an offsetting sale of those shares before submitting a trade correction request to the Korea Exchange (“KRX”). The Financial Supervisory Service (“FSS”) took the position that, because the trade correction process had not been completed at the time of the offsetting sale and the shares had therefore not yet been reflected in Company A’s proprietary trading account, the transaction could constitute short selling and, in particular, naked short selling under the Financial Investment Services and Capital Markets Act (“FSCMA”).

When a financial investment company submits a correction request to the exchange in connection with an erroneous

trade and the correction is completed, the relevant shares are reflected directly in the financial investment company's proprietary trading account without passing through the client's account. Until the correction is completed, however, the shares remain reflected in the client's account.

In the instant case, the offsetting sale occurred before the shares were reflected in Company A's account through the correction process described above, and the transaction was flagged by the NSDS as naked short selling by Company A, giving rise to the issue in dispute.

Under the FSS's *Integrated Guidelines on Short Selling*, a sale constitutes naked short selling if, at the time the sell order is placed, there are no shares credited to the relevant account or no shares that the seller is certain to receive by the settlement date—in other words, if there is no “sellable balance.”

The key issue in the instant case was whether shares could be regarded as certain to be received by Company A by the settlement date where Company A had agreed with the client to take over the shares, but had not yet submitted a correction request and, as a result, the shares had not yet been reflected in Company A's proprietary trading account.

Given the absence of sufficient precedent on this issue at the time, it was critical to distinguish between a transaction being flagged by the NSDS and the substantive legal determination of whether the transaction constituted short selling under the FSCMA and related regulations.

2. Shin & Kim's Strategy: Establishing a Short-Selling Exception Based on “Entitled Quantity”

A. Establishing that a Contractual Right to Receive Shares Is Included in the “Sellable Balance”

Under the FSS's *Integrated Guidelines on Short Selling*, shares that are certain to be received by the settlement date include both (i) “trade quantity,” referring to shares scheduled to be credited pursuant to an executed purchase agreement, and (ii) “entitled quantity,” referring to shares that are certain to be received by the settlement date pursuant to a contract, exercise of rights, or other arrangement. The FSCMA and the KOSPI Market Business Regulations similarly provide that a sale of shares that can be received by the settlement date pursuant to a contract or other arrangement is not deemed to constitute short selling. These rules demonstrate that the key consideration is not whether the shares have actually been credited to the relevant account, but whether the seller has secured the ability to obtain and deliver the shares by the settlement date.

In the instant case, Shin & Kim argued that, prior to the offsetting sale, Company A and the client had reached a definitive agreement under which Company A would take over the shares resulting from the erroneous trade. Accordingly, Company A had already secured a contractual right to receive the shares by the settlement date—i.e., an “entitled quantity”—and the offsetting sale therefore did not constitute naked short selling.

B. Distinguishing the Exchange Correction Request and the Client Agreement as Separate

Bases for Establishing Rights

In an official notice issued in October 2025, the KRX stated that rights arising from the correction of an erroneous trade are created upon execution of a correction agreement with the KRX, and that sell orders submitted before a correction request is filed are flagged by the NSDS as naked short selling.

Shin & Kim took the position that the notice addresses only when a “trade quantity” arising from an erroneous trade correction is recognized, and does not extend to an “entitled quantity” independently established under a separate agreement between a financial investment company and its client, pursuant to which the company has a contractual right to receive the shares credited to the client’s account.

This can be summarized as follows:

- **Offsetting sale after a correction request:** The erroneously purchased shares are reflected as Company A’s “trade quantity,” and the sale therefore does not constitute short selling or naked short selling.
- **Offsetting sale after an agreement with the client but before a correction request:** Company A has secured an “entitled quantity” pursuant to the agreement, and the sale therefore does not constitute short selling or naked short selling.
- **Offsetting sale without either a correction request or an agreement with the client:** In the absence of both a “trade quantity” and an “entitled quantity,” the sale may constitute naked short selling.

The instant case fell within the second category. Before the Capital Market Investigation Review Committee and the SFC, Shin & Kim strongly argued that the KRX notice addresses only the timing of recognition of a “trade quantity” arising from a correction request, and that the mere fact that a sale was executed before a correction agreement was entered into does not, in itself, render the sale naked short selling. Rather, where the seller had already secured, pursuant to an agreement with the client, a contractual right to receive the shares by the settlement date, the seller had an “entitled quantity,” and the sale should therefore not constitute naked short selling. Shin & Kim advanced this position based on both the language of the applicable regulations and the regulatory purpose underlying the prohibition on naked short selling.

3. Decision by the SFC: Recognized “Entitled Quantity” and Found No Short Selling

Contrary to the FSS’s position, the SFC concluded that the transaction in the instant case did not constitute short selling.

The SFC found that the offsetting sale was made within the quantity of shares erroneously purchased and that the correction request and settlement were duly completed within the applicable deadlines. On this basis, it determined that the transaction constituted a “sale of shares to be received pursuant to a contract or other arrangement” and therefore did not constitute short selling. The SFC indeed fully accepted Shin & Kim’s argument that, at the time of the sale, Company A had already secured a contractual right to receive the relevant shares.

4. Significance of the Decision: NSDS Detection and the Legal Determination of Naked Short Selling May Be Based on Different Criteria

Following the significant strengthening of naked short selling regulations and the introduction of the NSDS, whether a transaction is flagged by the system has become increasingly important in practice. However, a transaction flagged by the NSDS does not automatically constitute naked short selling. Rather, the ultimate determination requires a careful assessment of the specific facts and circumstances, including whether the transaction was supported by a “sellable balance,” “trade quantity,” or “entitled quantity” as prescribed under the FSCMA and related regulations.

In the absence of directly applicable precedent, Shin & Kim conducted a comprehensive analysis of the FSCMA, its Enforcement Decree, the KRX Business Regulations, and the FSS’s *Integrated Guidelines on Short Selling*. Focusing on the concept of “entitled quantity,” which had received limited attention in prior discussions, Shin & Kim developed a nuanced legal framework and successfully applied it to the offsetting sale of shares resulting from an erroneous purchase.

Shin & Kim also successfully addressed the potentially unfavorable October 2025 KRX notice by advancing a systematic interpretation that distinguished between the KRX correction process, which gives rise to a “trade quantity,” and a separate agreement with the client to take over the relevant shares, which independently gives rise to an “entitled quantity.”

As a result, the SFC went beyond merely reducing the proposed sanctions based on mitigating circumstances and concluded that the transaction itself did not constitute short selling.

The decision clarifies that, in the context of an offsetting sale following an erroneous trade, an “entitled quantity” may, subject to certain conditions, arise from an agreement with the client independently of the KRX correction process. The decision is therefore expected to serve as an important precedent in determining whether similar transactions constitute naked short selling.

5. Shin & Kim’s Financial Regulatory Capabilities

Short selling regulation is a highly complex area where the FSCMA and related regulations, KRX rules, regulatory guidelines, NSDS operating standards, securities settlement practices, and the internal procedures of financial investment companies intersect. Where a new supervisory system or market practice becomes the subject of regulatory enforcement for the first time, existing precedent alone may not provide sufficient guidance. Such cases require a sophisticated legal analysis that interprets the language and structure of the applicable regulatory framework in light of the substance of the transaction and the underlying regulatory objectives. A deep understanding of capital markets and the practical operations of financial investment companies is therefore essential.

Shin & Kim’s team comprises attorneys with deep expertise in financial and securities regulation, as well as professionals with significant experience at financial regulatory authorities, the KRX, and leading financial institutions. Drawing on our proven track record in examinations, investigations, and enforcement proceedings before the Financial Services

Commission, the FSS, and the KRX, we provide comprehensive advice and representation across the full spectrum of capital markets regulation, including short selling.

[\[Korean version\]](#) 착오매매 정정신청 전에 이루어진 반대매도가 무차입공매도에 해당하지 않는다는 판단을 이끌어낸 최초의 리딩케이스

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