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KOREAN SHORT-SELLING ENFORCEMENT (PART I): CALCULATING THE SHORT-SALE ORDER AMOUNT

I. OVERVIEW

This is the first in a two-part update series on practical issues arising in Korean short-selling investigations and enforcement proceedings. This update addresses the calculation of the penalty amount for short selling cases.

In Korean regulatory investigations, a short selling trader ("**Trader**") may find that the volume of naked short sales identified by the Financial Supervisory Service ("**FSS**") is substantially greater than Trader's original order placed to the Korean broker ("**Broker**"). This includes instances where the quantity ultimately filled does not exceed the quantity initially instructed to Broker by Trader.

The reason is that the Korean regulatory authorities calculate the orders actually submitted by Broker to KRX, rather than the order quantity filled. Accordingly, where Broker cancels and re-enters orders, the aggregate order quantity (and the bases for penalty calculation) includes both filled and unfilled/cancelled orders.

II. ORDERS SUBMITTED TO KRX

A short-sale order is typically sent from Trader to Broker to KRX. For penalization purposes, FSS calculates the orders submitted by Broker to KRX, rather than the original orders placed from Trader to Broker.

For example, Trader instructs its Broker to sell 100 shares within a specified price range. If Broker's algorithm places orders of 100 shares, executes 40 shares, cancels the remaining 60, and then re-enters those 60 shares at a different price, the aggregate quantity submitted to KRX would be 160 shares even though only 100 shares were instructed and ultimately filled.

If the orders were naked short sales, the relevant order quantity may therefore be 160 shares, as cancelled orders are included in the calculation. This can result in FSS penalizing a larger short-sale quantity than what was ultimately filled.

III. PENALTY CALCULATION

A. Base Amount and Imposition Rate

The "**Base Amount**" is the amount of the naked short-sale orders that violated Article 180 of the Financial Investment Services and Capital Markets Act. The penalty is calculated by applying an "**Imposition Rate**" to that amount.

The Imposition Rate is determined by reference to: (i) the materiality of the violation (the quantitative criteria); and (ii) whether an aggravating or mitigating circumstance exists. The applicable rate ranges from 20% to 100% of the Base Amount.

	High	Medium	Low
Aggravating Circumstance	100%	60%	40%
No Aggravating or Mitigating Circumstance	60%	40%	30%
Mitigating Circumstance	40%	30%	20%

B. Cancelled and Unexecuted Orders

Although cancelled or unexecuted orders may remain included in the Base Amount, an additional reduction may be applied to that portion when determining the final penalty amount.

For example, if the applicable Imposition Rate is 30% and a 70% reduction is applied to the cancelled portion, the surcharge may be calculated as follows:

(Executed order amount × 30%) + (Cancelled and unexecuted order amount × 30% × 30%)

In this example, the effective rate for the cancelled portion would therefore be 9%, before any other adjustments.

Traders have argued that orders cancelled without execution should not be included, particularly where Broker's algorithm submitted quantities substantially exceeding the original instruction. The Korean regulatory authorities, however, have not accepted that all such orders should be excluded. Their position is that, where a Trader specifies execution parameters or grants Broker discretion over execution, cancellations and re-entries may be reasonably foreseeable.

IV. AUGUST 2025 SEOUL HIGH COURT DECISION

This issue was considered in an August 2025 Seoul High Court decision. A Trader instructed the sale of 29,771 shares using a Careful Discretion ("**CD**") method, together with Good Till Cancelled ("**GTC**") and Volume Weighted Average Price ("**VWAP**") conditions. In executing the instruction, the Broker submitted orders for an aggregate of 41,919 shares, although only 29,771 shares were ultimately filled.

The court of first instance found that the circumstances did not support a finding that Trader could have anticipated orders exceeding the entrusted quantity and held that the penalty had been incorrectly calculated.

The Seoul High Court reversed the decision. It held that given the CD, GTC and VWAP conditions, the Trader knew or should have known that orders to KRX may exceed the original

order placed from Trader to Broker. The penalty could therefore be calculated by reference to the full quantity submitted to KRX.

The decision suggests that, where broad execution discretion is granted from Trader to Broker, repeated cancellations and re-entries may be treated as foreseeable and included in the penalized amount.

V. PRACTICAL CONSIDERATIONS

A. Confirming the Actual Violation Amount

Trader may not be able to determine the actual scale of a potential naked short-selling violation/penalty amount from its own instruction records or execution reports alone.

To calculate the relevant quantity accurately, it will generally need to obtain from Broker records showing the orders submitted, cancelled and re-entered. These records should be reconciled against the original instruction.

In some cases, the aggregate quantity submitted to KRX may be several times greater than the quantity ultimately filled.

B. Limiting Aggregate Order Submissions

Traders should, where practical, expressly instruct Brokers not to submit orders exceeding a specified cumulative quantity.

To address the issue effectively, any cap should apply to the aggregate gross quantity of all orders submitted to KRX, including orders subsequently cancelled, amended or re-entered, and not merely to the quantity ultimately filled.

If a clearly documented cap is exceeded by Broker, this would strengthen Trader's position that the excess submissions fell outside its mandate and were not reasonably foreseeable, and provide a basis for seeking to exclude the excess quantity from the penalty calculation.

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