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Can Director and Executive Liability Insurance Suppress Management Tone Manipulation?

Qiqi Zhang

School of Accounting, Anhui University of Finance and Economics, China

Abstract

Based on the A-share data of listed companies from 2010 to 2021 as the research sample, this article empirically studies the impact of purchasing director and executive liability insurance on management tone manipulation. Research has found that purchasing director's liability insurance can significantly inhibit management's tone manipulation, verifying that director's liability insurance can exert a positive external governance effect; The channel inspection found that directors' liability insurance suppresses management tone manipulation by reducing the degree of information asymmetry; Further research has found that grouping tests on the nature of property rights indicate that the inhibitory effect of directors' liability insurance on management tone manipulation is more significant in the sample of state-owned enterprises.

Keywords

Director and Executive Liability Insurance; Management Tone Manipulation; Information Asymmetry.

1. Introduction

In recent years, with the development of Natural language processing technology, scholars have made more and more research on accounting text information. Accounting text information generally includes annual reports issued by enterprises, management discussions and analyses, performance briefing meetings, board of directors' prospectuses, as well as audit reports and news reports issued by external third-party organizations. Compared with financial statements that disclose digital information, textual information generally has rich information content and diverse forms of expression, which can effectively supplement accounting digital information. This provides professional explanations and analysis for many investors in the capital market who do not have professional financial knowledge. The management discussion and analysis released by enterprises not only explain and analyze the financial information already released and the current situation of the enterprise, but also provide prospects for future development, which has become the main research object in many accounting text information.

Scholars have found that the tone of management discussion and analysis contains numerous useful information for investors, including effective prediction of corporate performance (Xie Deren and Lin Le, 2015), prediction of corporate risk (Liu Yishuang and Chen Yiyun, 2018), reduction of financing constraints (Zhao Yuliang, 2020; Lu Jieran and Ma Chao, 2019) Reduce audit fees (Liang Rixin and Li Ying, 2021) and actively fulfill social responsibilities (Fan Libo and Shang Duo, 2020). However, some scholars have also found that management may manipulate their intonation based on opportunistic motives (Huang et al., 2014; Zeng Qingsheng et al., 2018), thereby inducing investors' judgment to achieve self-interest. Management tone manipulation refers to the intentional increase in the frequency of positive or negative vocabulary usage in disclosed management discussions and analyses, in order to achieve the purpose of rendering the text. On the one hand, the management can use tone manipulation to cooperate with the earnings management behavior of enterprises (Wang

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Huajie and Wang Kemin, 2018; Zhu Zhaohui and Xu Wenhan, 2018) to confuse investors and achieve the purpose of stabilizing their positions. On the other hand, the unusually positive tone of management may lead to greater bankruptcy risks for enterprises (Lin Wanfa et al., 2022) and cause resource mismatch behavior in the capital market (Zhao Yuliang, 2020). Due to the complex content and unusually large information content of accounting text information, which lacks strict supervision by the China Securities Regulatory Commission, it is more easily manipulated by management. There have been studies to explore the impact of media attention (Wang Yuetang and Zhou Jie, 2022), the inquiry letter on financial reports (Fan Hejun and Wang Siyu, 2022), and the participation of party organizations in corporate governance (Bao Xiaojing and Li Yachao, 2021) on the management's tone manipulation. Few literature studies its impact on the management's tone manipulation from the insurance perspective of directors' liability insurance.

Director and executive liability insurance is an insurance company that assumes additional responsibilities for directors, supervisors, and executives due to negligence or error in their performance. As an external governance mechanism, there has been no consistent conclusion on director liability insurance research in recent years. Based on the external supervision hypothesis, on the one hand, introducing directors' liability insurance into insurance companies as an independent external regulatory agency can effectively improve corporate governance efficiency, reduce agency costs, improve the quality of accounting information of enterprises (Zhang Shigen and Wang Xinping, 2021), and reduce corporate violations (Li Conggang and Xu Rong, 2020). On the other hand, introducing directors' liability insurance can also play a positive incentive role for enterprises, Suppress management's short-sighted behavior (Zhang Shigen and Wang Xinping, 2021), thereby improving the innovation ability of enterprises (Hu Guoliu et al., 2019). However, the opportunistic hypothesis suggests that due to the company's ability to purchase director liability insurance, it shifts the professional risks faced by directors and executives, thereby weakening the deterrent effect of the law and inducing management to engage in opportunistic behavior. Lai Li et al. (2019) found that the introduction of director's liability insurance led to more short-term loans and long-term investments by enterprises, thereby increasing their operational risks. Yuan Rongli et al. (2018) found that the purchase of directors' liability insurance by enterprises increased the Moral hazard of management and increased audit fees. Hu Guoliu and Li Xiaoqian (2023) also found that director liability insurance reduces the cost of management's self-interest, thereby exacerbating the financialization behavior of enterprises.

So, is the director's liability insurance suppressing management tone manipulation by playing an active supervisory role, or is it more tone manipulation due to opportunistic behavior? This article will use text analysis technology to construct management manipulation indicators and study the impact of director's liability insurance on management manipulation. Possible contributions of this article: Firstly, it expands the research on the economic consequences of directors' liability insurance. There is currently no consensus on whether director's liability insurance plays a positive governance role or is a tool for management's self-interest. However, this study found that director's liability insurance can significantly suppress management's tone manipulation, enriching research on the governance effect of director's liability insurance in the Chinese capital market. Secondly, it enriches research on the impact of management tone manipulation. Most existing literature has studied various economic outcomes from the phenomenon of abnormal positive tone in management. However, this article explores the impact of purchasing director's liability insurance on management tone manipulation from the perspective of insurance, enriching the research on the impact of management tone manipulation. Thirdly, a thorough analysis was conducted on the impact mechanism of board liability insurance on management tone manipulation and the heterogeneity of board liability

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insurance's impact on management tone manipulation, thereby adding new evidence for board liability insurance to play an active external governance role.

2. Theoretical Analysis and Research Hypotheses

Firstly, based on the external supervision hypothesis, introducing directors' liability insurance into insurance institutions as an external governance mechanism can suppress management tone manipulation behavior by reducing information asymmetry between investors and management. Insurance institutions have the motivation and ability to continuously supervise the enterprise before and after underwriting in order to avoid compensation. This is because the textual information disclosed by enterprises, like financial information, is the focus of stakeholder attention, and the manipulation of tone by management to induce investors to make decisions increases the risk of lawsuits faced by enterprises, thereby increasing the compensation expenses of insurance institutions. Therefore, on the one hand, insurance institutions usually dispatch analysts and lawyers with professional knowledge to conduct detailed due diligence on the enterprise before undertaking business, in order to understand the management's preference for risks and the quality of accounting information disclosure, in order to decide whether to accept this business and the level of insurance fees. On the other hand, in the process of contract execution after insurance, insurance institutions can not only limit the opportunistic behavior of management in the business management process through the constraints of relevant contract terms, but also periodically supervise the disclosure of accounting information to ensure the quality of accounting information. Ling Shixian and Bai Ruifeng (2017) found that purchasing director's liability insurance by enterprises can alleviate the problem of information asymmetry between enterprises and insurance institutions, thereby promoting the quality of enterprise information disclosure. When conducting continuous supervision of enterprises, insurance institutions not only have access to all the information currently disclosed by the enterprise to the outside world, but also have access to many non mandatory internal information that is difficult for stakeholders to obtain. This internal information significantly alleviates the problem of information asymmetry between insurance institutions, enterprises, and other stakeholders. Therefore, under the high level of supervision and attention from the management, the space for opportunistic behavior by the management is greatly reduced, and the internal governance effect of the enterprise continues to improve (O'Sullivan, 1997). Earnings management activities are also reduced, and the tone manipulation behavior of the management is effectively suppressed.

Secondly, based on the opportunistic hypothesis, companies transfer the professional risks faced by directors and executives by purchasing director liability insurance, forming a "protection" for them, weakening the deterrent effect of the law and inducing opportunistic behavior among management, thereby exacerbating tone manipulation by management. Wu Xihao and Cheng Yili (2017) found that the introduction of director's liability insurance has a strong opportunistic motivation, and higher financial restatement behavior occurs after the insurance is insured. Zhang Hengfeng and Xiong Yilu (2021) also found that the purchase of director's liability insurance exacerbates management's self-interest motivation and reduces accounting conservatism.

In summary, this article proposes a pair of competitive assumptions:

H1a: Director and executive liability insurance can suppress management tone manipulation.

H1b: Director and executive liability insurance can exacerbate management tone manipulation.

3. Research Design

3.1. Research Sample

This paper takes the A-share data of listed companies from 2010 to 2021 as the research sample, and processes the original data as follows: excluding the samples of listed companies in the insurance and financial industries; Exclude ST and delisted listed companies during the sample period; Delete sample missing values for related variables. In addition, in order to avoid the impact of extreme values, continuous variables in the sample data were subjected to a 1% tail reduction. Data source: CSMAR database and CNINFO.

3.2. Variable Definition

The dependent variable is management tone manipulation (Abtone1/Abtone2). Based on the research of Zeng Qingsheng et al. (2018), Bao Xiaojing and Li Yachao (2021), this paper classifies positive and negative words on the basis of the English vocabulary list of financial emotion provided by Loughran and McDonald (2011), and uses Youdao Dictionary and PowerWord to translate English words in LM Dictionary. Secondly, learning from the research of Wang Huajie and Wang Kemin (2018), we use the Chinese Emotional Polarity Dictionary produced by Taiwan University to classify words. For the calculation of management tone manipulation indicators, refer to Huang et al. (2014)'s approach and construct a model as shown in formula (1):

$$LMTONE_{i,t} / YDTONE_{i,t} = \alpha_1 + \alpha_2 * Lev_{i,t} + \alpha_3 * Size_{i,t} + \alpha_4 * EPS_{i,t} + \alpha_5 * \Delta EPS_{i,t} + \alpha_6 * ROE_{i,t} + \alpha_7 * Age_{i,t} + \alpha_8 * Growth_{i,t} + \alpha_9 * Loss_{i,t} + \varepsilon_{i,t} \quad (1)$$

Among them, Tone1 is the ratio of the difference between positive and negative vocabulary calculated based on the LM dictionary to the sum of them, Tone2 is the ratio of the difference between positive and negative vocabulary calculated based on the Taiwan University dictionary to the sum of them, Lev is the asset liability ratio, Size is the company size, and EPS is the earnings per share, Δ EPS is the change in earnings per share, ROE is the return on equity, Age is the time the company was listed, Growth is the growth rate of the company's operating revenue, and Loss is whether the company suffered losses in the current year, ε The part that manipulates the tone of the management.

Explanatory variable: Director and Executive Liability Insurance (Doins). This article draws on the research methods of Hu Guoliu and Hu skirt (2014), as well as Li Conggang and Xu Rong (2020), to construct a dummy variable "Doens" as the measurement method for the independent variable of this article, director liability insurance. Specifically, if the sample enterprise subscribed to director's liability insurance in the current year, the value of doins is 1, otherwise it is 0.

Control variables: This article refers to the practice of Bao Xiaojing and Li Yachao (2021), Yuan Dongliang et al. (2021), selects the following control variables, and controls for fixed effects of industry and year. The variable definition is shown in Table (1)

Model Settings

To examine the relationship between director and executive liability insurance and management tone manipulation, this article constructs a model (2) to test:

$$Abtone = \alpha + \beta * Doine + \gamma * Controls_{i,t} + \sum \mathrm{Year} + \sum Ind + \varepsilon_{i,t} \quad (2)$$

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Table 1. variable definition

	variable	symbol	variable definition
Explained Variable	Management tone manipulation 1	Abtone1	Based on LM dictionary calculation
	Management tone manipulation 2	Abtone2	Based on TD dictionary calculation
Explanatory variable	Director and Executive Liability Insurance	Doins	Virtual variables. Subscription is 1, otherwise it is 0
Control variable	Size	Size	Natural logarithm of total assets
	Lev	Lev	Total liabilities divided by total assets
	Indep	Indep	Independent directors divided by the number of directors
	Dual	Dual	The chairman and general manager are one person, with one person being 1. If not, it is 0
	SOE	SOE	The value for state-owned enterprises is 1, otherwise it is 0
	Mshare	Mshare	Management shareholding data divided by total equity
	Board	Board	The number of directors is taken as Natural logarithm
	ListAge	ListAge	Ln (year of year - year of listing+1)
	INST	INST	Total shares held by institutional investors divided by circulating capital stock
	Year	Year	Annual dummy variable
	Ind	Ind	Industry dummy variables

4. Empirical Result Analysis

4.1. Descriptive Statistics

The descriptive statistical results are shown in Table 2. The mean values of Abtone1/Abtone2 are both 0.001, and the median values of Abtone1 and Abtone2 are 0.013 and 0.010, respectively. This indicates that management has the behavior of manipulating intonation upwards, which is consistent with the findings of existing literature. The average value of doins is 0.078, with a standard deviation of 0.268, indicating that 7.8% of listed companies have enough to purchase director's liability insurance, with a lower proportion of insurance coverage, and there are significant differences among different listed companies.

Table 2. descriptive statistics

variable	sample size	mean value	median	standard deviation	Min	Max
Abtone1	27390.000	0.001	0.013	0.095	-0.291	0.168
Abtone2	27390.000	0.001	0.010	0.106	-0.298	0.212
Doins	27390.000	0.078	0.000	0.268	0.000	1.000
Size	27390.000	22.210	22.026	1.319	15.577	28.636
Lev	27390.000	0.421	0.413	0.205	0.007	1.636
Indep	27390.000	0.376	0.364	0.056	0.143	0.800
Dual	27390.000	0.280	0.000	0.449	0.000	1.000
SOE	27390.000	0.343	0.000	0.475	0.000	1.000
Mshare	27390.000	0.138	0.007	0.264	0.000	20.171
Board	27390.000	2.125	2.197	0.198	1.099	2.890
ListAge	27390.000	2.137	2.303	0.814	0.000	3.466
INST	27390.000	0.391	0.397	0.236	0.000	1.870

4.2. Regressive Analysis

Table 3 shows the impact of board liability insurance on management tone manipulation. The first and second columns directly examine the relationship between board liability insurance and management tone. After controlling for fixed effects in industries and years, the coefficients of Doins are -0.0097 and -0.0049, respectively, which are significantly negatively correlated at the 1% and 5% levels. After adding a series of control variables, as shown in the third and fourth columns, the coefficients of Doins were -0.0150 and -0.0097, respectively, and both were significantly negatively correlated at the 1% level. The results in Table 3 support Hypothesis 1a, which states that the purchase of directors' liability insurance can significantly suppress management tone manipulation.

Table 3. regressive analysis

variable	(1)Abtone1	(2)Abtone2	(3)Abtone1	(4)Abtone2
Doins	-0.0097***	-0.0049**	-0.0150***	-0.0097***
	(-4.7745)	(-2.1686)	(-7.1987)	(-4.1699)
Size			0.0030***	0.0051***
			(5.2916)	(7.9361)
Lev			0.0185***	0.0002
			(5.6249)	(0.0647)
Indep			0.0051	0.0059
			(0.4394)	(0.4481)
Dual			0.0058***	0.0053***
			(4.5716)	(3.7223)
SOE			0.0026*	-0.0002
			(1.8055)	(-0.1067)
Mshare			0.0187***	0.0140***
			(7.8266)	(5.2384)
Board			0.0058*	0.0081**
			(1.6587)	(2.0609)
ListAge			0.0050***	0.0054***
			(5.8369)	(5.6866)
INST			0.0094***	-0.0017
			(3.3940)	(-0.5493)
_cons	-0.0440***	-0.0063	-0.1471***	-0.1459***
	(-5.6993)	(-0.7262)	(-9.2838)	(-8.2021)
Year/Ind	Yes	Yes	Yes	Yes
N	27390	27390	27390	27390
r2_a	0.1417	0.1391	0.1501	0.1444

5. Further Analysis

5.1. Mechanism Verification

The channel for enterprises to purchase directors' liability insurance to suppress management tone manipulation is achieved by reducing the degree of information asymmetry. Firstly, insurance institutions will conduct detailed due diligence on enterprises before undertaking business to reduce the degree of information asymmetry between insurance institutions and enterprises, thereby suppressing the space for management tone manipulation; Secondly, after underwriting, insurance institutions will strictly supervise the enterprise to reduce improper

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behavior by pipeline management, thereby suppressing tone manipulation by management. This article draws inspiration from the research of Wei et al. (2012), which uses principal component analysis to extract common variation information and record it as an information asymmetry indicator (ASY). The larger the ASY indicator, the higher the degree of information asymmetry. The regression results are shown in Table 4. The ASY coefficient of the first column is -0.0602, which is significantly negatively correlated at the 1% level. It can be seen that purchasing director's liability insurance can reduce the degree of information asymmetry. The coefficients of ASY and Abtone in the second and third columns are 0.0166 and 0.0137, respectively. Through significance testing, it indicates that the higher the degree of information asymmetry, the more severe the management's tone manipulation, In addition, the coefficients of Doins and Abtone in the second and third columns are -0.0140 and -0.0089, respectively, which are negative and pass the significance test. This shows that there is a Mesomeric effect in the governance effect of the director's liability insurance to reduce the degree of information asymmetry and play a role in the management's tone manipulation.

Table 4. mechanism verification

variable	(1)ASY	(2)Abtone1	(3)Abtone2
Doins	-0.0602***	-0.0140***	-0.0089***
	(-2.7420)	(-6.8229)	(-3.8483)
ASY		0.0166***	0.0137***
		(29.3929)	(21.4465)
Size	0.5460***	-0.0061***	-0.0024***
	(91.0398)	(-9.4798)	(-3.3427)
Lev	-1.0366***	0.0357***	0.0144***
	(-29.8520)	(10.8490)	(3.8780)
Indep	-0.1612	0.0078	0.0081
	(-1.3137)	(0.6800)	(0.6224)
Dual	0.0798***	0.0045***	0.0042***
	(5.9714)	(3.5785)	(2.9763)
SOE	-0.3550***	0.0085***	0.0047***
	(-23.2492)	(5.9123)	(2.8823)
Mshare	0.4634***	0.0110***	0.0077***
	(18.3852)	(4.6494)	(2.8776)
Board	0.1084***	0.0040	0.0066*
	(2.9363)	(1.1620)	(1.6967)
ListAge	-0.2415***	0.0090***	0.0087***
	(-26.9219)	(10.5791)	(9.1092)
INST	1.0886***	-0.0087***	-0.0166***
	(37.2483)	(-3.1025)	(-5.2577)
_cons	-9.6667***	0.0133	-0.0136
	(-57.7851)	(0.8045)	(-0.7256)
Year/Ind	Yes	Yes	Yes
N	27390	27390	27390
r2_a	0.3993	0.1761	0.1585

5.2. Heterogeneity of Property Rights Nature

In China, most executives in state-owned enterprises are appointed by the government and have assessment requirements, so compared to non-state-owned enterprises, directors and executives may manipulate their tone of voice due to their performance assessment

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requirements. Therefore, this article predicts that the inhibitory effect of directors' liability insurance on management tone manipulation is more significant in state-owned enterprises. Table 5 shows the regression results grouped by property rights. The coefficients of Abtone1 and Abtone2 in state-owned enterprises are -0.0221 and -0.0131, respectively, and both are significantly negatively correlated at the 1% level, while they are not significant in the sample of non-state-owned enterprises. This indicates that the inhibitory effect of board of directors' liability insurance on management tone manipulation is more significant in state-owned enterprises.

Table 5. heterogeneity of property rights nature

variable	Abtone1		Abtone2	
	state-owned	non-state-owned	state-owned	non-state-owned
Doins	-0.0221***	-0.0016	-0.0131***	-0.0012
	(-7.7754)	(-0.5250)	(-4.0831)	(-0.3275)
Size	0.0011	0.0053***	0.0015	0.0087***
	(1.1533)	(7.1556)	(1.4077)	(10.3544)
Lev	0.0126**	0.0289***	-0.0054	0.0104**
	(2.1859)	(7.1637)	(-0.8302)	(2.2900)
Indep	-0.0071	0.0089	-0.0047	0.0133
	(-0.3858)	(0.5847)	(-0.2282)	(0.7725)
Dual	0.0056*	0.0061***	0.0062*	0.0052***
	(1.7517)	(4.5235)	(1.7231)	(3.4201)
Mshare	0.0951***	0.0184***	0.0375	0.0145***
	(3.2322)	(7.5702)	(1.1316)	(5.2815)
Board	0.0178***	-0.0058	0.0139**	0.0016
	(3.1607)	(-1.2807)	(2.1972)	(0.3170)
ListAge	0.0099***	0.0026***	0.0102***	0.0030***
	(5.4988)	(2.6416)	(5.0458)	(2.6666)
INST	0.0035	0.0138***	0.0040	-0.0022
	(0.6532)	(4.3104)	(0.6478)	(-0.6006)
_cons	-0.1457***	-0.1526***	-0.0727***	-0.2236***
	(-5.9643)	(-7.0244)	(-2.6428)	(-9.1224)
Year/Ind	Yes	Yes	Yes	Yes
N	9394	17996	9394	17996
r2_a	0.2125	0.1448	0.1701	0.1533

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