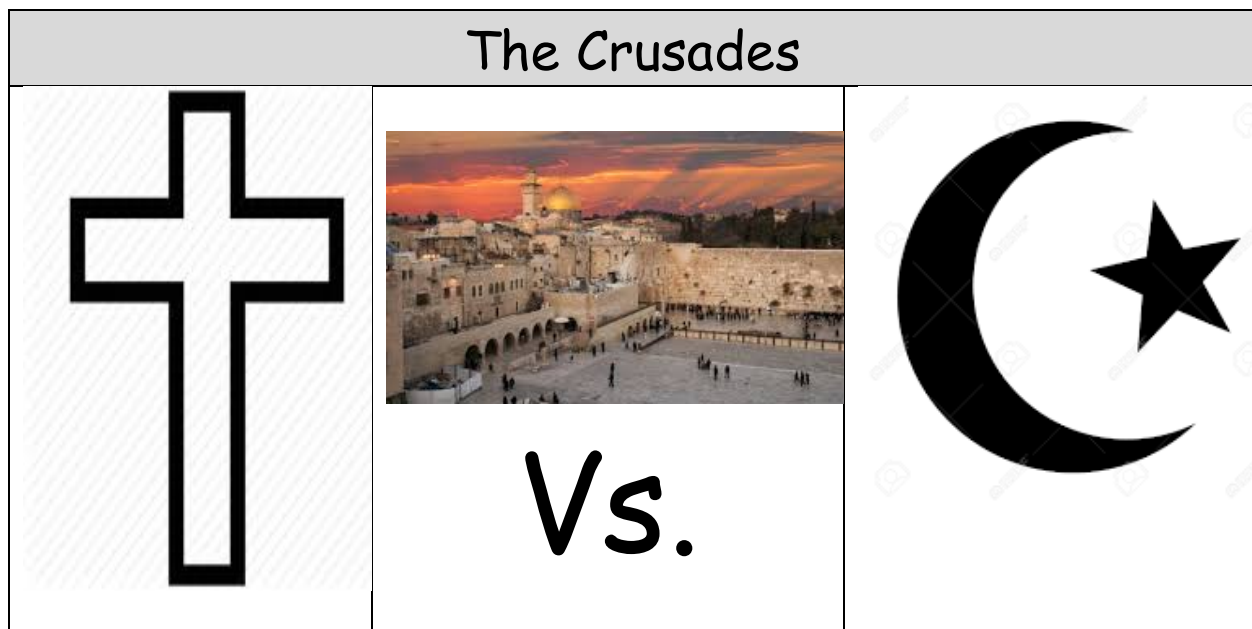


Chapter 19: Buy the right types of insurance at the right times

The Beginning of Modern Banking²⁸

One of the most vital inventions in finance began in the Middle Ages, right around the time Italy invented government bonds. Remember how around 1,000 AD Christians and Muslims were fighting for control over the city of Jerusalem? To the Christians, Jerusalem held holy significance as the place where Jesus died and God resurrected him. To the Muslims, Jerusalem was also the city where Muhammad died and descended into heaven. As discussed in Chapter 16, the series of wars over possession of this city is called the Crusades.



Italy, a mostly Christian country, hired soldiers and built fleets of ships to send to Jerusalem. To do this, Italy invented **government bonds**. Ordinary people would give their money to the government, and each year those investors could get their money back plus interest. Around the same time, Britain invented a different financial instrument to support the Crusades in a different way. While Italy invented the bond, Britain invented the modern bank staffed with knights.

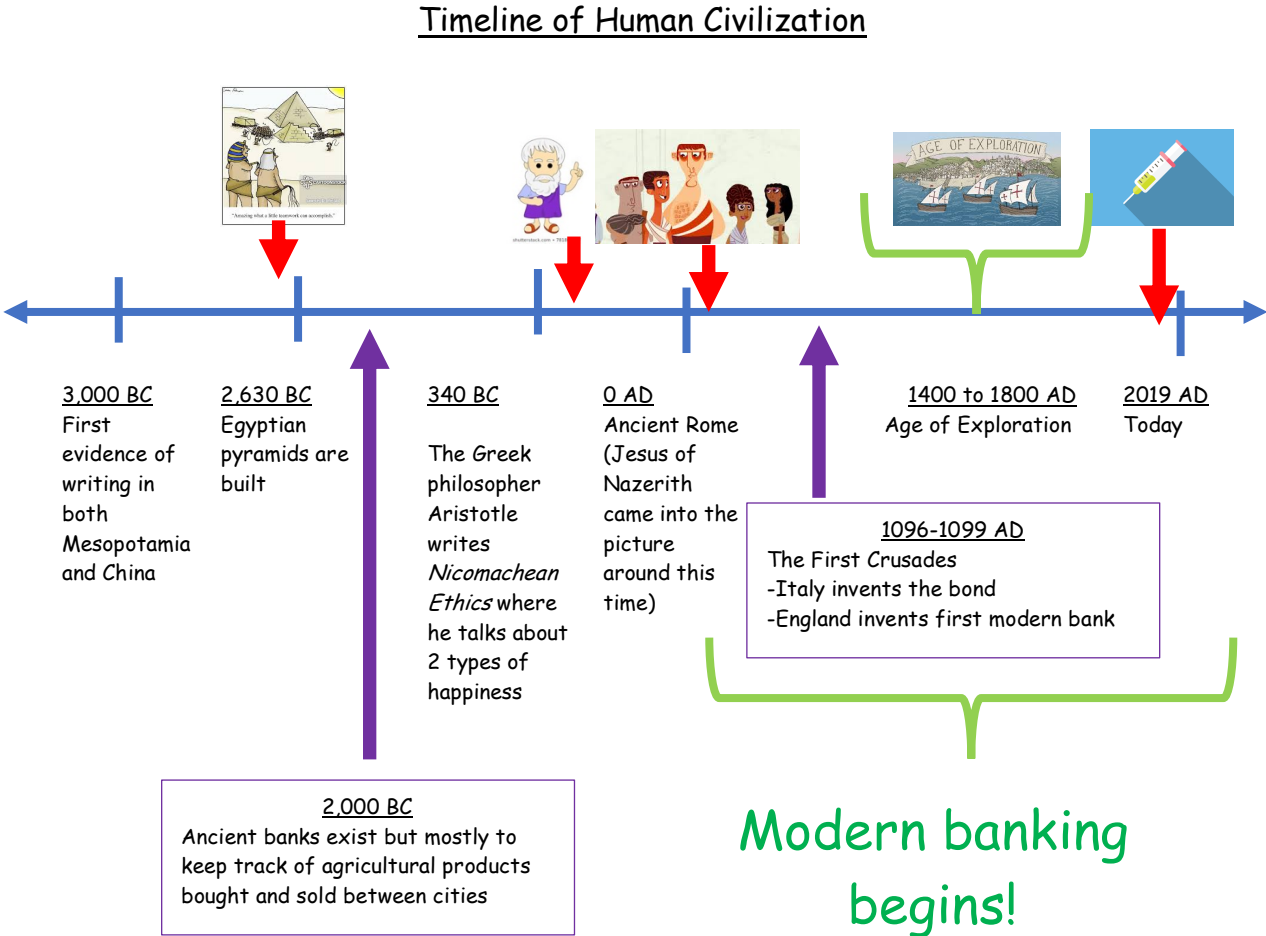
Home of
the first
modern
"bank"

Home of
the
government
bond.



To protect religious travelers heading to Jerusalem, the King of England created the Knights Templar. These knights not only fought in iron armor with swords, but they protected the ordinary peasants who desired safe passage to the holy land. The Knights Templar vowed a life of poverty and service to the country, making them the most trustworthy bankers imaginable. The Knights Templar proved so successful at protecting pilgrims that they soon protected the valuable possessions of travelers and the English royalty. These knights functioned as bankers, keeping track of deposited gold and valuables for the rich and elite in medieval Britain. They would charge interest and compensate those whose valuables went missing. The Knights, for their service, were awarded a pension. As discussed in Chapter 8, a **pension** is a monthly amount of money that is paid for a retired person every month until death. The Knights may have sworn an oath of poverty, but if they protected the pilgrims and the valuable belongings of kings and queens, they would be rewarded with a guaranteed monthly source of income until they died—not a bad deal when the majority of people at the time were peasants dying of the bubonic plague.

The Knights Templar were financial masterminds without ever realizing it, and they represented a serious change in the history of finance. Below is the updated History of Human Civilization timeline we have built upon many times in this book. Starting around the time of the First Crusades and continuing throughout the Age of Exploration, modern finance first appeared:



Insurance

Soon after the first bank appears, so too does insurance. **Insurance** is when a customer pays a monthly amount of money to be protected in case of specific emergencies. For example, imagine a homeowner who purchases home insurance for \$100 a month and accidentally comes home to see the entire house on fire. The insurance company will write a check for the entire worth of a house to rebuild it. \$100 a month is a good deal since a home is, on average, worth over \$200,000.

Without home insurance, that \$1 million home is worth \$0. Below are common forms of insurance, and there are many more:

Examples of Insurance	
Renters insurance	Pay a little bit every month, and have your belongings replaced if someone breaks into your apartment
Health insurance	Pay a little bit every month, and the insurance company will pay your hospital and doctor bills when you are sick
Car insurance	Pay little bit every month, and have your car fixed or replaced if you are in an accident
Longevity insurance (this is an interesting one!)	Pay a little bit every month once you retire, and get a monthly check if you ever run out of retirement money.

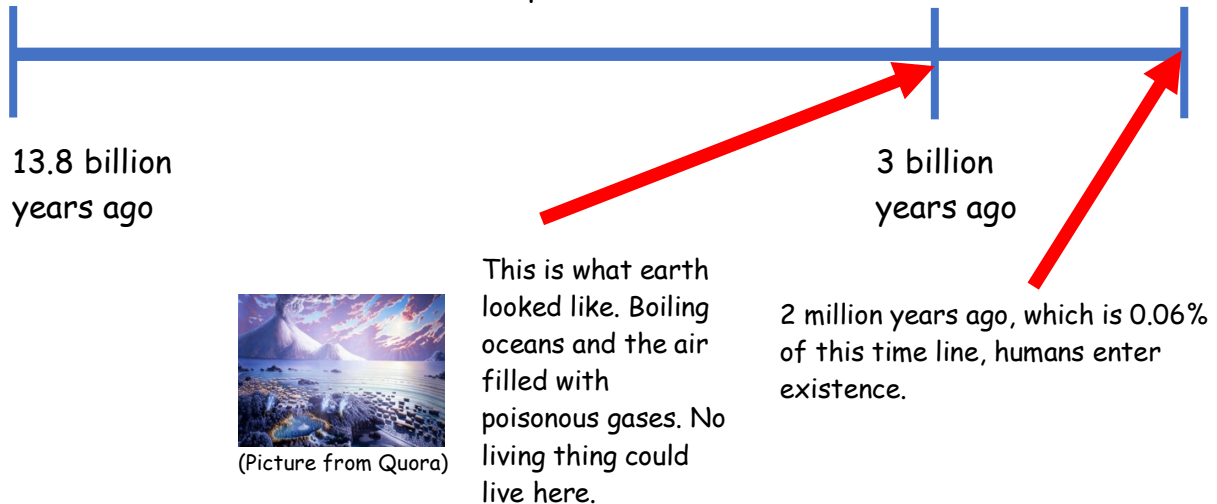
A helpful way to remember insurance is to understand two related words: "insure" and "assure." To insure is to protect, and to assure is to give confidence to. Both are a way of supporting someone, which is what insurance is all about.

Two words related to insurance		
To "insure"	To protect	I will insure your motorcycle for \$50 a month. If it ever breaks, I'll fix it as long as you pay me \$50 every month no matter what.
To "assure"	To express confidence in	I assure you that you will do great at the chess tournament.

The History of Insurance

Insurance represents an outrageously important innovation. To truly appreciate it, we must revisit some timelines again.

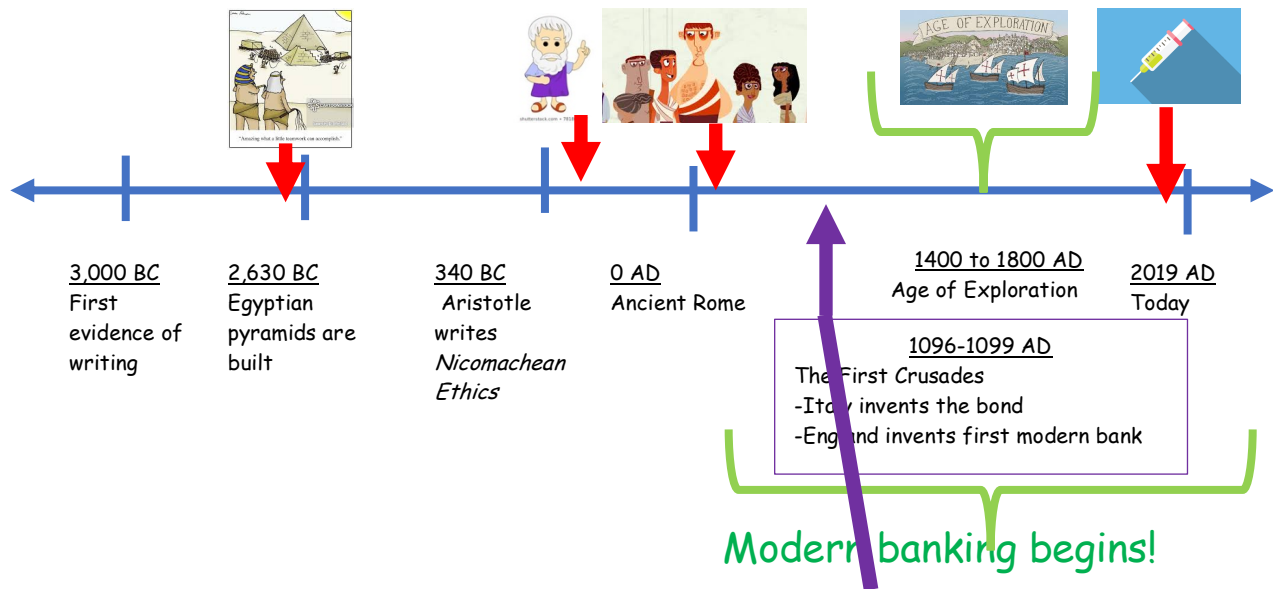
While the Italian government and English royalty invented bonds and banks the rest of Europe began using early forms of insurance. Let's return to a version of the first timeline introduced in Chapter 2:



In the 2 million years that humans existed, only the last 5,000 years (about 3,000 years BC and then another 2,000 years AD) did humans settle down, learn to write and then start building civilization. That means for 1,996 million years humans were just cavemen beating each other with clubs and hunting wild game. What allowed humans to begin the process of building civilization? The main answer is writing. Writing allowed humans to communicate, come up with architecture plans, pass on religion, and write math equations. During these 5,000 years of civilization it was only the last 1,000 to 500 years that humans got super sophisticated. If writing enabled civilization 4,000 years ago, what began mankind's intellectual and innovative prowess in the last 1,000 to 500 years? The answer: finance.

Humans may have built pyramids, bridges, and iron swords from 2,000 BC to 1,000 but in the last 500 years we have seen: fossil fuels, steam engines, vaccines, houses, telescopes, computers, phones and more. Just look at the list of inventions on the timeline on the next page:

Timeline of Human Civilization



Inventions created during this time:

- Bridges, churches and temples, castles
- Ships and boats
- Spears and swords
- The wheel

Inventions created during this time:

- Electricity
- Cars
- Nuclear energy
- Fossil fuels
- Satellites
- Rockets

Humans in the last 500 years had more innovation than the 3,500 years of civilization before that (and clearly more innovation than the 1.996 million years before that!) Mankind's intellectual achievements skyrocketed in the last 1,000 years (and more specifically just the last 500 years) because of finance.

As discussed in Chapter 14, the Age of Exploration involved the ruling kings and queens of Europe financing explorers to travel the world in search of gold, colonies, and resources to trade. Christopher Columbus, Hernan Cortez and the Aztecs, and Galileo with his telescope all occurred during this time.

Chapter 14 explained how gold motivated many of these expeditions. Gold was (and continues to be) a rare-earth metal that never loses its shine or strength no matter how much it is melted, broken or mixed. It comprised jewelry, dentures,

and heating equipment. Without gold, humans would still be living in castles or on farms, unable to have achieved the great engineering feats of modernized society. While gold may have motivated kings and queens, what actually got Christopher Columbus and the other explorers motivated to get in those boats?

The Knights Templar received **pensions** and ordinary people could buy **bonds** and **stocks**. What then motivated explorers?

Exploration was dangerous and hard. Sailors often died of starvation, malnutrition or disease if foreign tribes did not kill them first. The answer: **insurance**.

Explorers and their team of sailors often engaged in insurance agreements with the kings and queens. In case of ship damage (or sinking), the explorers and sailors would be compensated for the damages and still be paid. Of course, they would get a portion of any gold that was found. This was the only way explorers would take such risks.

Explorers, sailors, and soldiers needed protection when venturing into new continents and countries. Although loyal to their kings and queens, these travelers needed to be promised protection, payment, and coverage from damages in case storms, violent native peoples, disease, and unknown dangers awaited them in new lands.

Insurance gave the kings and queens the ability to motivate explorers in search of gold, and it gave motivation to those bold enough to travel to far off lands. If Kings and Queens agreed to take care of the explorers in times of trouble, they would pocket 90% of whatever land, resources or gold was found.

Insurance allowed everyone to get a good deal.

Paying for insurance

Since the types of insurance vary widely, each person may select different types of insurance at different times in their life. The purpose of insurance is to be protected from emergencies that could not be paid on their own. The leading cause of bankruptcy in America continue to be medical bills. Cancer treatment can run from \$250,000 to \$500,000. Very, very few people have that money sitting in a

bank. But, paying \$300 a month in health insurance means that the very unlucky person to get a diagnosis of cancer could get their treatment at \$0.

Most insurance plans can have up to 3 parts: a premium, deductible and/or copay. Some insurance plans have all 3; some have only 2; and some have just 1. This is how they are different;

1. **Premium** is the monthly amount of money a person pays to keep an insurance plan. For example, the average renter's insurance to cover the cost of a break-in or fire will cost about \$15 a month. The \$15 each month is called the premium.
2. **Deductible** is how much someone pays to activate their insurance. For example, I have a \$500 deductible on my car insurance. If I get in a car accident and the damages cost \$3,000, I have to pay \$500 before the insurance company pays the rest. This is the insurance company's way to make sure I am a safe driver.
3. **Copay** is how much someone has to pay when receiving services, which is almost identical to a deductible. My health insurance may come with a \$300 premium, a \$500 deductible and a \$20 copay. My job pays \$500 a month for my health insurance, every month no matter what. If I need dental surgery for \$5,000, I have to pay a \$20 copay just to meet with my doctor. Then, if I decide to go through with the \$5,000 surgery, I will pay the \$500 deductible. The copay, like the deductible, is a way for insurance companies to make sure people do not activate their insurance policies unnecessarily.

As stated earlier, insurance plans may have one, two or all three parts. Sometimes, the customer gets to choose. For example, I had the choice to pay \$200 a year for renter's insurance with a \$500 deductible or \$220 a year for renters insurance with a \$0 deductible. (I picked the higher premium and the \$0 deductible.)