

HARD COPY

In the Matter of

TRI-STAR ADVISORS,
INC., WILLIAM T. PAYNE,
AND JON C. VAUGHAN,

Respondents.

ANSWER OF RESPONDENTS TRI-STAR ADVISORS, INC., WILLIAM T. PAYNE, AND JON C. VAUGHAN TO ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

Pursuant to the Rules of Practice of the U.S. Securities and Exchange Commission (“Commission”), Respondents Tri-Star Advisors, Inc. (“TSA”), William T. Payne and Jon C. Vaughan hereby answer and set forth their defenses to the Division of Enforcement’s allegations in the Commission’s Order instituting public administrative and cease-and-desist proceedings pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940.

1. Respondents admit that TSA is an investment adviser registered with the Commission since November 2009. Respondents deny the remainder of the allegations in paragraph 1.

2. Respondents admit that, during the relevant period, Respondent William T. Payne was TSA’s CEO and Jon C. Vaughan was TSA’s President. Respondents deny the remainder of the allegations in paragraph 2.

3. Respondents admit that TSA is a Texas corporation based in Houston, Texas, and that it became a Commission-registered investment advisor on or about November 17, 2009. Respondents admit that as of December 2012 TSA managed approximately 313 accounts on a non-discretionary basis and had approximately \$162 million in assets under management.

4. Respondents admit the allegations in paragraph 4.

5. Respondents admit the allegations in paragraph 5.

6. Respondents admit the allegations in paragraph 6.

7. Respondents admit that TSA provides investment advisory services to individuals and entities. Respondents admit that TSA's investment strategy is focused on fixed income securities. Respondents admit that TSA relied on TSF for fixed income analysis and trade execution, but deny that it did so in all instances.

8. Respondents admit that Mr. Payne and Mr. Vaughan made investment recommendations to TSA clients and, upon the clients' consent, the transactions were executed. Respondents admit that transactions were executed through TSF and that Mr. Payne and Mr. Vaughan generally received 55% of the sales credit generated by the TSF trades. Respondents admit that the bonds would have passed through TSF's inventory account, but this was a holding account and not a proprietary trading account.

9. Respondents admit that Mr. Payne and Mr. Vaughan are responsible for ensuring that TSA complies with its regulatory requirements, and they retained a respected consultant to help them do so.

10. Respondents deny the allegations in paragraph 10. Respondents deny that these trades were principal transactions as defined in the relevant statutes and regulations and object to the characterization of these transactions as the "TSA Principal Transactions."

11. Respondents deny that the transactions at issue were principal transactions as defined in the relevant statutes and regulations. Respondents admit that sales credits were paid to TSF and to Mr. Payne and Mr. Vaughan.

12. Respondents deny that TSA did not provide written disclosures to, or obtain consent from, clients before handling trades through TSF. Respondents admit that Mr. Payne and Mr. Vaughan initiated and were involved in executing trades through TSF, but they believed TSA was making the disclosures and obtaining the consents required of it. Respondents deny that these trades were principal transactions as defined in the relevant statutes and regulations.

13. Respondents deny the allegations in paragraph 13.

14. Respondents deny the allegations in paragraph 14.

15. Respondents deny the allegations in paragraph 15.

16. Respondents deny the allegations in paragraph 16.

17. Respondents deny the allegations in paragraph 17.

18. Respondents deny that any remedial action, penalties, or other remedies are necessary or appropriate.

DEFENSES

1. Respondents hired a respected compliance advisor before setting up their advisory business. They told the compliance advisor about the relationship between TSF (the broker-dealer) and TSA and the anticipated trading procedure. They followed the advice the consultant gave them, disclosing the relationship between TSF and TSA in their advisory agreements and Form ADV. The advisory agreements and Form ADV each disclosed that TSF and the individual Respondents may earn commissions on trades handled through TSF. Respondents typically called clients and obtained verbal consent prior to trades. Respondents' compliance consultant did not advise Respondents that they needed to make written disclosure of each trade to each customer in advance and obtain advance consent to each trade. Respondents did not learn this until 2011. Once they learned this, TSA changed its policies and practices so that each

customer is now provided advance written notice of each trade handled through TSF, including the amount of any markup, and the customer gives express consent prior to each such trade. None of Respondents' customers has declined to do a trade based on these disclosures.

2. The bonds acquired for TSA clients were not purchased or sold from any proprietary trading accounts of Respondents. In fact, Respondents did not have a proprietary trading account.

3. The Division of Enforcement's allegations fail to state a cause of action upon which relief can be granted.

4. The Division of Enforcement's claims and requested relief are barred by the doctrine of estoppel.

5. Respondents did not knowingly engage in principal trades in violation of the applicable statute or regulations.

6. Mr. Vaughan's ownership interest in TSF is not sufficient to make him a controlling person or principal in that entity.

7. Mr. Payne and Mr. Vaughan did not act with the requisite scienter to be held liable for causing TSA's alleged violations.

8. Respondents relied in good faith on the services, advice, and recommendations of professional compliance advisors, including an advisor regularly hired and relied upon by the Commission itself.

9. TSA self-reported issues with alleged principal trades to the SEC examination staff.

10. When advised that advance disclosure and client consent were necessary for the trades through TSF, TSA changed its practices. TSA now makes advance disclosure and obtains

advance client consent to trades handled through TSF. TSA changed its policies and practices before being notified by the SEC of a deficiency.

11. Respondents at all times cooperated fully and promptly with the Division of Enforcement's investigation of this matter.

12. Respondents received no unlawful, illicit, or unfair compensation or income as a result of the alleged misconduct or as a result of the trades at issue.

13. TSA never misled any clients about any TSA practices. TSA fully disclosed its trading processes to clients with respect to acquiring securities through TSF before placing them into the clients' accounts.

14. An injunction is not legally available because there is virtually no likelihood of the behavior complained of being repeated.


15. An injunction and other remedies are inappropriate because the complained-of behavior has ceased. TSA's policies and procedures have been amended as noted above.

WHEREFORE, Respondents Tri-Star Advisors, Inc., William T. Payne, and Jon C. Vaughan request:

- A. That these proceedings be dismissed;
- B. That Respondents be found and adjudged to have not violated, nor caused any violation of, Section 203(e) or Section 206(4) of the Investment Advisors Act or Rule 206(4)-7 thereunder, or other laws or regulations cited in the Commission's Order;
- C. That no remedial action, penalties or other remedies be ordered against Respondents;
- D. That Respondents be awarded their costs;
- E. Such other and further relief to which Respondents justly may be entitled.

Dated: January 22, 2014

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