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Integration of ESG Principles in Risk Assessment of Islamic Financial Products: A Maqasid Shariah-Based Approach

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Abstract: This study aims to develop a risk assessment framework for Islamic financial products by integrating Environmental, Social, and Governance (ESG) principles with maqashid shariah. ESG has become a global standard for evaluating investment sustainability; however, its adoption in the Islamic finance context remains limited and unstructured. Using a qualitative exploratory approach and systematic literature review, the study identifies ESG indicators that align with the objectives of maqashid shariah and formulates a value-based conceptual risk assessment model. The findings indicate a strong synergy between ESG indicators and maqashid shariah, revealing significant opportunities for Islamic financial institutions to adopt this model in order to strengthen public trust and enhance global competitiveness.

***Keywords**:* ESG, Maqashid Shariah, Risk Assessment, Islamic Finance, Sustainability

INTRODUCTION

Islamic finance is a financial system that is not only founded on formal legal aspects but also emphasizes ethical, moral, and sustainability values. The principles of Shariah in finance aim to achieve a balance between economic gain and social welfare through the application of *maqashid shariah*, which include the preservation of religion (*hifz al-din*), life (*hifz al-nafs*), intellect (*hifz al-'aql*), lineage (*hifz al-nasl*), and wealth (*hifz al-maal*) (Dusuki & Abdullah, 2007). As global awareness of sustainability increases, the ESG concept is increasingly used as a tool to measure corporate risk and sustainability performance.

However, most current implementations of ESG remain generic and do not fully consider the religious and ethical context unique to Islamic finance. ESG, which comprises three main dimensions—environmental, social, and governance—needs to be reassessed within the framework of *maqashid shariah* to make it more aligned with Islamic values. The lack of deep integration between ESG and Shariah principles represents a significant research gap that must be addressed.

Some Islamic financial institutions have begun showing interest in adopting ESG principles. However, this has been limited mainly to corporate social responsibility (CSR) reporting, without a systematic and measurable risk assessment framework based on ESG adapted to *maqashid shariah*. This indicates the urgent need for a theoretical and practical framework that can harmonize these two value systems.

Furthermore, with growing pressure from regulators and global investors for sustainable and transparent financial practices, Islamic financial institutions are increasingly required to demonstrate that their systems are competitive and globally relevant. Therefore, developing an ESG-*maqashid shariah*-based risk assessment model is essential to prove the normative and functional superiority of Islamic finance in the sustainability era (Muneeza & Hassan, 2021).

This research seeks to address that challenge by exploring the compatibility between ESG and *maqashid shariah*, and developing a comprehensive and applicable risk assessment model. The study is expected to make a theoretical contribution to the advancement of Islamic finance knowledge and offer practical guidance for Islamic financial institutions to enhance their governance and risk management quality.

Research Questions:

- How compatible are ESG principles with *maqashid shariah*?
- What ESG risk indicators are relevant to Islamic finance?
- How can an integrated risk assessment model be applied to Shariah-compliant financial products?

Research Objectives:

- To identify the linkages between ESG principles and *maqashid shariah*.
- To formulate appropriate ESG indicators for Islamic finance.
- To develop an integrated ESG–*maqashid shariah* risk assessment framework.

1. STUDI LITERATURE

Several prior studies have addressed the relevance and potential of integrating ESG into Islamic finance. Muneeza and Hassan (2021) identified that ESG principles are highly compatible with the values of *maqashid shariah*, particularly in terms of ethics, transparency, and sustainability. They emphasized the importance of developing a conceptual framework that bridges global ESG standards with Islamic values. Similarly, research by Laldin and Furqani (2013) stated that *maqashid shariah* provides a strong philosophical foundation for developing financial indicators that are not only profit-oriented but also value-driven.

Dusuki and Abdullah (2007) highlighted the importance of a *maslahah*-based approach in designing socially responsible Islamic financial products. They proposed that the *maqashid shariah* orientation could expand the sustainability dimensions of Islamic financial instruments. This is further supported by Hassan and Aliyu (2018), who discussed how *maqashid shariah* can be used as a tool to measure the social effectiveness of Islamic financial institutions and serve as a core component of effective Shariah governance.

The Triple Bottom Line (TBL) concept by Elkington (1998), though Western in origin, embodies values that parallel those of *maqashid shariah*. It emphasizes a balance between profit, social interests, and environmental sustainability. Mohammed and Taib (2015) adopted the TBL framework to assess the sustainability performance of Islamic financial institutions and concluded that it could be adapted within the *maqashid* framework by adding a spiritual dimension.

The Islamic Financial Services Board (IFSB) has also issued guidelines to expand risk management frameworks to include social and environmental dimensions (IFSB, 2020). These guidelines stress the importance of disclosure and accountability in managing risks associated with Shariah-compliant financial products. Farooq and Zain (2020) further noted that digitalization and the use of cryptocurrencies in Islamic finance introduce new challenges in ESG integration. Therefore, a more comprehensive and Shariah-compliant risk assessment approach is necessary.

In summary, the literature review reveals strong theoretical support for the integration of ESG and *maqashid shariah*. However, a practical model that operationalizes this integration in the risk assessment of Islamic financial products is still needed. This research aims to fill that gap.

RESEARCH METHOD

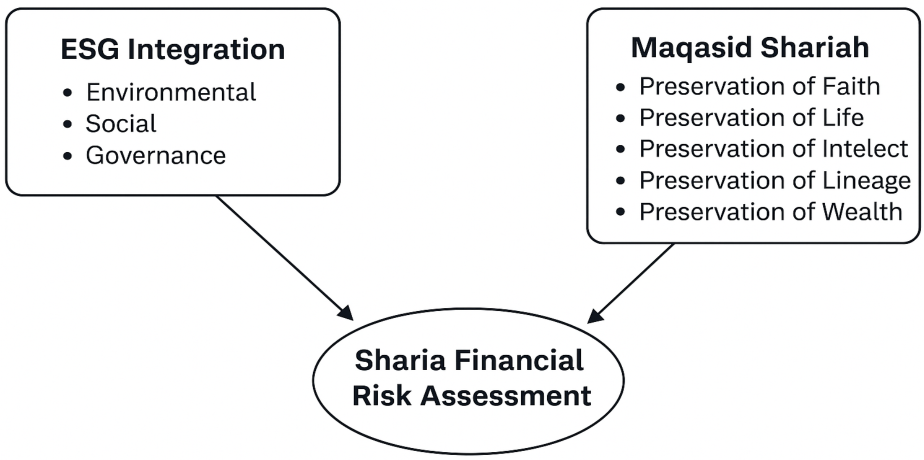
This study employs a qualitative exploratory approach to develop a risk assessment model for Islamic finance that integrates ESG principles with *maqashid shariah*. This approach is selected due to its ability to explore phenomena in depth, especially in areas that have not been extensively studied. A qualitative method also enables researchers to understand the relationships between concepts and the normative meanings embedded within ESG and *maqashid shariah*.

Data were collected through comprehensive literature review. Sources include academic journals, annual reports of Islamic financial institutions, and guidelines from international bodies such as the Islamic Financial Services Board (IFSB) and the UN Principles for Responsible Investment (UNPRI), as well as other relevant academic documents. Literature selection was conducted purposively, focusing on sources directly related to ESG and *maqashid shariah* integration in risk assessment contexts.

Data analysis was conducted using thematic content analysis techniques. Initially, the researcher categorized commonly used ESG indicators from global financial practices. These indicators were then compared with *maqashid shariah* principles to evaluate their alignment and relevance. This process resulted in an integration map illustrating the convergence points between the two value frameworks.

Initial validation of the conceptual framework was conducted through a focused group discussion (FGD) involving five experts, including academics, Islamic banking practitioners, and regulators. The FGD aimed to test the practicality and applicability of the ESG–*maqashid shariah*-based risk assessment model in the operational context of Islamic financial institutions.

The outcome of this methodological process is a conceptual model of risk assessment that can serve as a tool for evaluating non-financial risks in Islamic financial products. The model is presented in diagrammatic and tabular form to facilitate comprehension and practical implementation by Islamic financial institutions and other relevant stakeholders.



The conceptual diagram presented illustrates the integration of Environmental, Social, and Governance (ESG) principles with Maqasid Shariah in the context of Sharia-compliant financial risk assessment. On the left, the ESG Integration box highlights three core pillars widely recognized in global sustainability standards: environmental responsibility, social accountability, and corporate governance. These indicators represent non-financial risks increasingly emphasized in sustainable finance frameworks worldwide.

On the right, the Maqasid Shariah box outlines five foundational objectives of Islamic law: preservation of faith (hifz al-din), life (hifz al-nafs), intellect (hifz al-‘aql), lineage (hifz al-nasl), and wealth (hifz al-mal). These objectives form the ethical and normative framework for all Islamic financial practices and are designed to ensure justice, public welfare, and moral integrity.

At the center of the diagram lies the core output of this integration: Sharia Financial Risk Assessment. This construct signifies a proposed model where risk assessment in Islamic financial institutions is informed not only by conventional ESG metrics but also by the higher objectives of Sharia. This dual framework ensures that financial products are both ethically grounded and responsive to contemporary global challenges such as environmental degradation, social inequality, and governance failures.

The arrows connecting both boxes to the central node reflect a two-fold contribution: ESG provides the operational dimensions of sustainability, while Maqasid Shariah offers the moral and legal foundation rooted in Islamic jurisprudence. The convergence of these perspectives enables a more holistic approach to risk analysis that supports Islamic financial institutions in enhancing accountability, resilience, and legitimacy in the global financial landscape.

In sum, the diagram embodies a novel framework that bridges global sustainability standards with Islamic ethical imperatives, promoting a Sharia-compliant financial risk assessment that is both value-driven and practically applicable.

Dimension	**ESG Indicators**	**Maqasid Shariah Principles**
Environment	Carbon managementEnergy efficiencyBiodiversity	*Hifz al-bi'ah* (Preservation of the environment)
Social	Labor rightsCommunity impactDiversity & inclusion	*Hifz al-nafs* (Preservation of life)
Governance	Transparency & accountabilityBusiness ethicsShareholder rights	*Hifz al-maal* (Preservation of wealth); justice, trustworthiness

Table 1 presents a structured comparison between conventional ESG (Environmental, Social, and Governance) indicators and the foundational principles of Maqasid Shariah in Islamic finance. The objective of this comparison is to highlight the natural alignment between modern sustainability criteria and Islamic ethical objectives, thereby supporting the integration of both frameworks in Sharia-compliant financial risk assessments.

From the environmental perspective, ESG emphasizes indicators such as carbon management, energy efficiency, and biodiversity preservation. These concerns resonate with the emerging Islamic principle of Hifz al-bi'ah (preservation of the environment), which, although not explicitly listed among the classical five maqasid, has been increasingly acknowledged in contemporary Islamic discourse as a necessary extension of Hifz al-nafs (preservation of life) and Hifz al-maal (preservation of wealth). Environmental protection in Islam reflects the theological notion of khilafah (stewardship), emphasizing human responsibility to care for and sustain the planet's natural resources.

In the social dimension, ESG indicators focus on labor rights, corporate impact on communities, and the promotion of diversity and inclusion. These align closely with Hifz al-nafs, which underscores the safeguarding of human life, dignity, and welfare. Islam places great emphasis on justice, compassion, and protection of vulnerable groups, values that are clearly reflected in these ESG indicators. Therefore, social responsibility in Islamic finance is not only a corporate obligation but a religious duty rooted in Shariah.

Governance, as the third dimension of ESG, includes principles of transparency, accountability, ethical business practices, and the protection of shareholder rights. These correlate with Hifz al-maal (protection of wealth), which mandates fair and lawful financial conduct. Moreover, Islamic ethics uphold ‘adl (justice) and amanah (trustworthiness) as essential virtues in economic transactions and institutional governance. Governance practices rooted in Shariah are designed to prevent fraud, exploitation, and corruption, thus reinforcing the core objectives of ESG governance metrics.

Overall, the comparison in Table 1 demonstrates that the ESG framework, though developed in a secular context, shares many ethical and operational parallels with the goals of Maqasid Shariah. Recognizing this alignment is crucial for developing a hybrid model of Sharia-compliant risk assessment that meets both global sustainability standards and Islamic moral imperatives. This integration offers Islamic financial institutions a strategic advantage by enabling them to operate in both ethical and globally relevant dimensions.

RESULT AND DISCUSSION

The results of this study reveal a strong coherence between the Environmental, Social, and Governance (ESG) indicators and the principles of *Maqashid Shariah*. This integration enables Islamic financial institutions not only to adopt globally recognized sustainability practices but also to reinforce their ethical legitimacy through embedded Shariah values. These findings are based on a thematic mapping of ESG indicators to the five core objectives of Maqashid: preservation of religion (*hifz al-din*), life (*hifz al-nafs*), intellect (*hifz al-'aql*), lineage (*hifz al-nasl*), and wealth (*hifz al-maal*).

From the environmental dimension, ESG indicators such as carbon management, energy efficiency, and biodiversity preservation align closely with the principle of *hifz al-bi'ah* (environmental preservation), which is now considered a modern extension of Maqashid. Islam, through the concept of *khilafah* (stewardship), emphasizes human responsibility toward nature as a divine trust. Consequently, Islamic financial institutions are expected to assess the environmental impacts of their business operations and investments.

In the social dimension, ESG emphasizes the protection of labor rights, social impact on communities, and the promotion of diversity and inclusion. These priorities correspond to *hifz al-nafs*, which seeks to preserve human life and well-being. In the context of Shariah, fair treatment of workers, community participation, and respect for social rights are moral responsibilities of financial institutions. Therefore, Islamic finance must promote inclusive and equitable social policies.

The governance aspect of ESG, which includes transparency, accountability, business ethics, and shareholder rights, is highly relevant to *hifz al-maal*, which demands the protection of wealth from exploitative practices. Principles such as *'adl* (justice) and *amanah* (trustworthiness) form the ethical foundation of Shariah-based governance. Adopting ESG governance indicators can enhance public and investor confidence in Islamic financial institutions and strengthen their internal control mechanisms.

To clarify this integration, Table 1 presents a direct comparison between ESG indicators and Maqashid Shariah principles. This table serves as a critical analytical tool in constructing an ESG-based Islamic risk assessment framework, wherein each sustainability dimension has a corresponding ethical and normative reference in Islam. The alignment supports the argument that ESG can be Islamized through Maqashid as a value filter.

Furthermore, Figure 1 illustrates the conceptual framework of ESG-Maqashid integration in Islamic financial risk assessment. This diagram demonstrates that ESG and Maqashid are not contradictory but rather complementary entities. ESG offers operational sustainability indicators, while Maqashid provides the moral, spiritual, and legal foundation for policymaking and risk evaluation. This integration results in a more comprehensive, globally relevant, and value-rooted Islamic financial risk assessment model.

The findings also indicate that the ESG-Maqashid approach can enhance the strategic competitiveness of Islamic financial institutions, particularly in attracting sustainability-conscious investors. For instance, green sukuk and social sukuk structured according to Maqashid principles and ESG standards can serve as attractive investment instruments in global markets. This opens new opportunities for innovative and sustainability-oriented Islamic financial products.

From a regulatory perspective, the adoption of the ESG-Maqashid framework can also inform the formulation of more adaptive and inclusive Islamic financial policies. Regulatory bodies such as the Financial Services Authority (OJK), Bank Indonesia, and international Shariah institutions like the IFSB can use this model as a reference in establishing guidelines and technical standards that promote sustainability reporting and responsible Islamic risk management.

Implementing this model in practice will require adequate human resource capacity and robust risk assessment infrastructure. Islamic financial institutions must build competencies in both ESG and Maqashid Shariah. Specialized training, the development of Shariah-compliant ESG reporting systems, and integration with internal audit frameworks are essential steps to support effective implementation.

Finally, this framework contributes theoretically to the development of contemporary Islamic finance literature. The integration of ESG and Maqashid Shariah demonstrates that Islam, as a value system, is not only compatible with modern sustainability ideals but also offers a deeper moral and spiritual dimension. This broadens the scope of research and practice in Islamic finance amid globalization and escalating environmental crises.

CONCLUSION

This study concludes that the integration of Environmental, Social, and Governance (ESG) principles with *Maqashid Shariah* presents a viable and valuable approach for enhancing the ethical, operational, and strategic dimensions of Islamic financial risk assessment. By aligning modern sustainability indicators with foundational Islamic values, financial institutions are empowered to address global challenges without compromising their religious obligations.

The environmental indicators of ESG correspond well with the Islamic principle of stewardship (*khilafah*) and *hifz al-bi'ah*, encouraging financial institutions to be more environmentally responsible. Likewise, the social and governance dimensions of ESG align with *hifz al-nafs* and *hifz al-maal*, which promote social justice, human dignity, and financial integrity. These correspondences highlight that ESG integration does not dilute Islamic values, but instead reinforces them with globally recognized frameworks.

The conceptual framework and comparative table developed in this study serve as practical tools for operationalizing this integration. They offer a clear path for Islamic financial institutions to evaluate risks not only from a compliance perspective but also through a value-based ethical lens. This dual-layer approach supports greater transparency, accountability, and sustainability.

Moreover, this integration holds significant implications for policy development, investor confidence, and product innovation. Regulatory authorities and Shariah boards can adopt the ESG-Maqashid model to guide sustainable finance policies and performance evaluation tools. It also opens new avenues for creating ethical financial instruments such as green sukuk, social finance platforms, and ESG-aligned microfinance solutions.

In conclusion, the ESG-Maqashid integration model contributes both theoretically and practically to the advancement of Islamic finance. It bridges the gap between global sustainability efforts and Shariah compliance, demonstrating that Islamic finance can be both competitive and value-driven in responding to contemporary economic, environmental, and social imperatives.

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