European leaders took their first steps toward a new plan to stem the euro crisis, admitting that their last grand plan, agreed to only three months ago, has failed.

The new effort, which leaders hope to finalize at another summit on Wednesday, involves a sweeping recapitalization of European banks, a substantial restructuring of Greece’s debts, a bigger bailout fund, and even possibly fresh efforts to entice sovereign-wealth funds in China and elsewhere to come to Europe’s aid.

The package remained in flux Sunday, and lower-level officials will toil on it for two more days before leaders reconvene this week. Euro-zone leaders insisted that a deal would be done on Wednesday, and that there was no more time to be lost, after months of delay and denial.

"For the first time, I found the leadership of the euro zone focusing on the fundamentals here in respect to the situation arising from Greece, and the fear of contagion," said Irish Prime Minister Enda Kenny. "There was clearly an understanding that the world is watching Europe and that there isn’t any point in doing this in a half-hearted fashion."

The options being debated now are more severe and far-reaching than those under consideration in months past. Last year, when the crisis first threatened the euro zone’s stability, leaders insisted that Greece would not default and that assistance would only be provided to countries on the brink of collapse, and at punitive cost to discourage free-riders.

Now, the question is how big a default Greece will have, and leaders are scrambling to open floodgates of aid to several countries.

The series of meetings has reunited, again, Europe’s colorful band of national leaders—who are spending an awful lot of time together. Last week, French President Nicolas Sarkozy jetted to Frankfurt for emergency meetings with German Chancellor Angela Merkel and senior officials, missing the birth of his daughter. This weekend, Ms. Merkel presented him with a premium-brand German teddy bear as a baby gift. It was one of the few light-hearted moments at the Brussels summit.

Italy is the subject of much consternation, and other leaders have privately expressed dismay that Prime Minister Silvio Berlusconi, hobbled by hometown sex scandals, isn’t proceeding quickly enough with economic overhauls. He had a separate meeting with Ms. Merkel and Mr. Sarkozy at which he was told to...
accelerate measures to improve Italy's lackluster growth and cut its debt. Mr. Berlusconi said late Sunday he may call an emergency cabinet meeting Monday.

Investors have become wary of Italian debt, sending bond yields spiking and raising concern than the euro zone's third-largest economy could suffer a catastrophic loss of access to financing.

Finance ministers who met here Friday and Saturday, and the leaders themselves Sunday, made progress toward narrowing down the parameters of a complex and interlinked plan. After Sunday's session, they seemed closest to agreement on bank recapitalization.

Under the plan for banks, about 90 significant lenders would be required to lift a key capital ratio to 9%. Those that couldn't raise the necessary funds on private markets would get government help.

Officials gave varying figures for the volume of capital needed, which would be roughly €100 billion, or about $139 billion. But the precise figure would depend on the volume of losses suffered by banks in write-downs of their Greek holdings. And that isn't yet clear.

Greece's depressing outlook—made plain in a report delivered by a team of bailout inspectors Friday—has changed the situation from July.

Even under relatively optimistic assumptions, the inspectors said Greece's debt would soar in the near term and remain above 2009 levels for two decades. An economic shock or a failure to implement painful reforms could easily send it spiraling out of control.

What's more, the report said that Greece would need more money than the €109 billion estimated in July unless private creditors take substantial losses—half or more—on the value of their debt holdings.

Senior euro-zone government officials said Sunday the range of a write-down under discussion was between 40% and 60%, with Germany at the high end and France at the low. But, naturally, the banks and other financial institutions who hold much of the debt are resistant to big losses. Their representatives were in Brussels for the weekend's meetings.

A major question is what happens if the banks refuse to go along with a big write-down. EU leaders have thus far insisted that Greece's private creditors "voluntarily" agree to exchange their Greek debt holdings for new bonds that are less valuable.

That has several technical advantages—it wouldn't likely trigger credit-default-swap contracts, for one—and EU officials say they are concerned that a forced restructuring could unleash financial-system chaos.

But without big losses for the banks, it is difficult to achieve substantial debt relief for Greece. Having given Athens bailout loans for more than a year, euro-zone governments and the International Monetary Fund now hold large amounts of Greek debt. There is little appetite for those official creditors to forgive part of their loans, and the IMF is by convention last to suffer any pain.

Still, a Greek government official said he expects talks about extending the repayment period of, and cutting the interest rate on, bailout loans from other euro members. That has been done several times already.

Greek's prime minister all but pleaded for relief. "This weight on the backs of every Greek citizen is unbearable," Prime Minister George Papandreou said Sunday. "It has to become lighter so we can breathe."

European leaders appeared relatively close to agreement on a plan to make the euro zone's €440 billion bailout fund effectively larger by employing leverage.
Options for the fund, the European Financial Stability Facility, were narrowed to two after a meeting of euro-zone finance ministers Friday. One is an insurance plan that foresees the fund’s setting aside a pool of money that could be used to offset part of any losses suffered by purchasers of the debt of weak countries, such as Italy. That could entice buyers and keep Italy financed.

The other would be to create a special, separate fund. That fund would raise money from private investors and others, like sovereign-wealth funds, to buy debt of weak countries. The EFSF would also participate in the fund—but would suffer the first losses. Officials said the two options could be combined.

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